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1964





# Royal Commission on Banking and Finance

PRESIDENT: CANADIAN IMPERIAL BANK OF COMMERCE  
PRESIDENT: BANK OF MONTREAL  
PRESIDENT: THE ROYAL BANK OF CANADA

Hearings  
held at  
OTTAWA

Vol.

63

Date.

January 18, 1963.



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Nethercut & Young

Toronto, Ontario

ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,  
Ontario, on Friday,  
January 18, 1963.

THE COMMISSION

The Honourable Dana Harris Porter  
Chief Justice of Ontario  
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.  
Investment Dealer  
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.  
Banker  
Toronto, Ontario

Mr. Gordon L. Harrold  
Agriculturalist  
Calgary, Alberta.

Mr. Paul H. Leman  
Corporation Executive  
Montreal, Quebec

Mr. John C. MacKeen  
Corporation Executive  
Halifax, Nova Scotia

Dr. W. A. Mackintosh  
Vice-Chancellor  
Queen's University  
Kingston, Ontario

Mr. H. A. Hampson

- Secretary

Mr. Gilles Mercure

- Joint Secretary







Ottawa, Ontario,  
Friday,  
January 18, 1963.

--- At 9.15 A.M. the hearing resumed.

SUBMISSION OF

CANADIAN IMPERIAL BANK OF COMMERCE

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APPEARANCES

Neil J. McKinnon	- President, Canadian Imperial Bank of Commerce
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THE CHAIRMAN: I call the meeting to order. This morning we shall hear submissions from: Mr. Neil McKinnon, the President of the Canadian Imperial Bank of Commerce; Mr. Hart, the President of the Bank of Montreal; and Mr. McLaughlin, the President of The Royal Bank of Canada.

Mr. McKinnon, I understand that your submission will be put forward first. We wish to welcome you on your appearance before this Commission, and look forward very much to the discussion which no

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1 doubt will follow your opening statement. We have  
2 all read your brief with great interest, and I  
3 think most of the members of the Commission will  
4 have some questions to ask, and it may result  
5 in some discussion. We are very pleased indeed  
6 to have you with us.

7 MR. McKINNON: Thank you, Mr. Chairman.

8 In addition to the submission I had  
9 made some notes relating to some evidence given by the Govern  
10 of the Bank of Canada. Do I have your permission  
11 to read them? They are on file. I do not know  
12 whether you have had an opportunity to read them;  
13 they just arrived here yesterday.

14 THE CHAIRMAN: I have not read them.  
15 This is a concise statement?

16 MR. McKINNON: Yes. I will not take too  
17 long. This relates to some evidence given by the  
18 Governor of the Bank of Canada, and I would like  
19 to preface my remarks by saying that I have the  
20 highest respect for his ability and judgment, but  
21 in one area there may be some divergence here, on  
22 the question of principle and approach.

23 The question of the time lag in the  
24 reactions of chartered banks to Central Bank Monetary  
25 Policies is touched on in the brief submitted  
26 by the Bank of Canada, particularly in Sections  
27 B and D of Part 3 on the techniques of monetary policy.  
28 It was also mentioned in the opening statement  
29 before the Royal Commission, on January 9, of  
30 the Governor of the Bank of Canada, and he commented







1 on it further in the course of his answers to the  
2 questions of Commissioners.

3 One of the suggestions of the Governor  
4 of the Bank of Canada in this connection is that  
5 the present formula for calculating the minimum  
6 cash reserve requirements of chartered banks might  
7 be reconsidered, and he has indicated that in the view  
8 of the Bank of Canada the existing formula permits  
9 unduly slow responses.

10 The proposal here would apparently be  
11 that the average period covered by the minimum cash  
12 reserve requirement should be shortened, although  
13 the Governor has of course made it clear that if  
14 the period were too short an intolerable rigidity  
15 would result. On this point it would seem that if  
16 the central bank is concerned about the extent of  
17 its ability to influence credit conditions it could  
18 with greater effect turn its attention to the financial  
19 institutions over which it has no direct influence  
20 rather than to such detailed refinements of its  
21 already extensive direct controls over the chartered  
22 banks. However, the main suggestion of the Bank  
23 of Canada in relation to this problem is that  
24 consideration might be given to empowering the Bank  
25 of Canada to vary the liquidity requirement of the  
26 chartered banks. The Governor noted first that he  
27 already has the authority, under the Bank of Canada  
28 Act, to vary the cash reserve requirement, on  
29 certain terms and within certain limits, and he  
30 indicated that this would enable the Bank of Canada



1 to exert a more direct and immediate influence over  
2 chartered bank lending policies in exceptional  
3 situations where this seems to be urgently desirable.  
4 (Opening statement of Governor, page 18). His  
5 new suggestion is that it might be desirable for the  
6 central bank to be able to achieve a similar result  
7 by varying the level of the minimum liquid asset  
8 ratio, and this is the point discussed in further  
9 detail in Section D of the Bank of Canada's brief  
10 on the techniques of monetary policy.

11 I am not concerned here to analyze the  
12 pros and cons of these suggestions as techniques or  
13 mechanisms of monetary management, and I do support  
14 the principle that the central bank must have a  
15 decisive influence on monetary policy for the good  
16 of the nation. I am concerned, however, to raise  
17 the question of principle, whether it is necessary  
18 or desirable to place powers additional to those now  
19 in being at the disposal of the central monetary,  
20 and ultimately, governmental authorities which  
21 already have very considerable, and ultimately final,  
22 powers to influence the operations of the chartered  
23 banks. I recognize, of course, that the  
24 Governor has made it clear that, with respect to the  
25 second of these suggestions, the power to vary the  
26 liquidity ratio, he is thinking of a device to be  
27 used only in extraordinary circumstances and only  
28 for limited periods of time. This qualification is  
29 in itself a recognition that for most circumstances  
30 the instruments in the hands of the central bank







1 are already entirely adequate.

2 I would suggest, however, that it cannot  
3 be accepted without question that it is in the public  
4 interest for the central bank to have even greater  
5 powers to compel a very rapid limitation or shrinkage  
6 of chartered bank lending in response to a decision  
7 of the central authorities. I would suggest that it  
8 should be considered seriously whether it is not  
9 advantageous to the public interest that in almost  
10 all circumstances there should be not only some  
11 possibility but a positive desirability of a period  
12 of adjustment. Abrupt changes in lending policies  
13 can cause serious and damaging hardships to the public,  
14 and particularly to smaller businesses, and,  
15 to individuals, who cannot so easily turn to alter-  
16 native sources of financing. Most businesses must make  
17 their plans at least six months and often longer in  
18 advance with a normal expectation of being able to  
19 borrow funds to finance their operations. If they  
20 suddenly find themselves cut off from the anticipated  
21 source of financing they are in very grave difficulties.  
22 In a country like Canada with great variations in  
23 seasonal peak demands for funds the issue can be  
24 particularly acute.

25 It has sometimes been suggested that the  
26 levels of lines of credit extended by the chartered  
27 banks and the fact that in the aggregate these are  
28 usually much in excess of actual borrowings tend to  
29 bring about a sluggish response to central bank policy.  
30 Without detailing the historical background of such







1 lines, their inevitability in an economy where the  
2 call for loans varies from one region to another  
3 and from one season to another, and the fact that this  
4 condition exists wherever commercial banking is  
5 practised, I should like to mention that there seems  
6 to be some misunderstanding about the nature of lines  
7 of credit. All or nearly all of them are available to  
8 borrowers only at the discretion of the boards of  
9 directors of the banks and, except when specially  
10 contracted for, involve no legal obligation to lend.  
11 They are in fact described as follows in our own  
12 regulations as they probably are in those of other  
13 banks:

14 " An authorized credit is established  
15 solely at pleasure of the Board of the  
16 Bank and does not give the customer a  
17 right to borrow up to its limit except  
18 with permission of the Bank. The authorized  
19 credit merely establishes a lending limit  
20 to measure the credit risk and is  
21 created solely for administrative  
22 convenience. It indicates the credit  
23 risk the Bank is prepared to assume  
24 provided the borrower's affairs continue  
25 in a position satisfactory to the Bank  
26 but in no sense does it commit the Bank  
27 to lend to that extent."

28 I use the word "commit" in the sense of an obligation  
29 which is enforceable.

30 In periods of credit stringency it is





1 customary to ask borrowers to co-operate by using no  
2 more of their lines than is essential for the conduct  
3 of their business so that available credit facilities  
4 will be enough to meet all minimum essential needs.  
5 The response by borrowers based on years of experience  
6 has been most co-operative. But lines of credit in  
7 any case are not the determining factor. Business  
8 throughout the country, especially in concerns of  
9 smaller and medium size who characteristically have  
10 no excess capital and often insufficient capital, cannot  
11 be conducted without a degree of confidence in an  
12 ability to borrow in the normal course of business.  
13 Business in general acts on expectations based on  
14 established practice. If events foreshadow the  
15 likelihood that its wants cannot be met or not wholly  
16 met it is entitled to advance warning of a change in  
17 conditions by the medium of the central bank rate  
18 and to a period for adjustment as well. In this way  
19 business requirements predicated on its advance planning  
20 may be adjusted to the changed conditions impending  
21 or anticipated.

22 If there should again be circumstances  
23 in which even the already formidable powers of monetary  
24 management are judged to be inadequate to meet the  
25 situation there is another long established technique  
26 available to the Governor and indeed to the Government.  
27 This is to call together the chartered banks to  
28 outline the problem to them, to canvass the various  
29 possibilities of action needed to serve the public  
30 interest in the particular circumstances which have





1 arisen and to reach an agreement on the most useful  
2 manner to solve the problem effectively in a way  
3 which is equitable and desirable from the point of  
4 view of the needs both of the authorities and of the  
5 national interests. The Governor of the Bank of Canada  
6 in his responses to questions from the commission  
7 has already cited instances in which this technique  
8 has been used beneficially. The chartered banks  
9 through the years have demonstrated a responsible  
10 attitude in the public interest with or without  
11 leadership from the central bank and to act in any  
12 other way would fail to serve their interest as it  
13 would fail to serve the interests of the nation.  
14 An approach of this thinking also avoids rigidities  
15 in a nation which needs not only cohesiveness but also  
16 flexibility to serve the public good.

17 I might conclude that a final reason for  
18 favouring a continuation of somewhat more flexible  
19 arrangements is that no one is infallible. Central  
20 Banks, like Chartered Banks, or Governments, or  
21 any individual or groups of people, can, on occasion  
22 be wrong in their judgments. It is not unusual to  
23 find that the most dedicated and conscientious groups,  
24 under concern or pressure in one area of responsibility  
25 may lose perspective in another. It seems to me  
26 not unreasonable to recommend a procedure which  
27 obligates the central authorities to discuss and  
28 examine the merits of a proposal with others vitally  
29 concerned before decisions are taken which could  
30 force abrupt reversals of policy with widespread con-





1 sequences across the country. The essence of  
2 successful central bank management in my opinion  
3 lies firstly in compatible fiscal policies and then  
4 in continuous foresight, leadership, and a gentleness  
5 of adjustment.

6 THE CHAIRMAN: Thank you, Mr. McKinnon.  
7 Mr. Brown?

8 COMMISSIONER BROWN: Mr. McKinnon, you  
9 make reference to the present arrangement of the  
10 8 per cent as laid down by the Bank Act and the  
11 additional 7 per cent liquid asset ratio which  
12 exists by agreement between the banks and the  
13 Bank of Canada. What do you think of the present  
14 arrangement? Is it working satisfactorily?

15 MR. MCKINNON: Yes, I think it is working  
16 reasonably satisfactorily. I know that there has  
17 been a certain conflict of view about precise figures,  
18 but I do not think a monetary system can work  
19 effectively unless there is a fractional cash arrange-  
20 ment. Whether 8 per cent is precisely right or not  
21 may be a matter of judgment or individual view. I  
22 have no particular quarrel with it.

23 I think, as we operate in our banking  
24 system, there may be a case for a different reserve  
25 against savings or time deposits as compared to the  
26 current account deposits; but as an approach, at  
27 the present time I will not quarrel with this 8 per  
28 cent.

29 COMMISSIONER BROWN: How about the 15 per  
30 cent?



1 MR. McKINNON: You are speaking of the  
2 additional 7 per cent?

3 COMMISSIONER BROWN: Yes, that is right.

4 MR. McKINNON: I think I should  
5 perhaps expand on this a little, although it may be  
6 a repetition of what the general managers have given  
7 in evidence in the last few days.

8 The 7 per cent requirement as a  
9 secondary reserve is probably misnamed. It is not  
10 really a secondary reserve, and it must be maintained  
11 and must not be used. On the other hand, the banks  
12 must retain a certain liquidity as an assurance to  
13 the depositors. Although I differed very strongly  
14 at the time this secondary reserve was introduced,  
15 principally because of the short period of time  
16 in which the banks were asked to create it, now it  
17 has been established I think it is not too unreasonable  
18 that the banks should continue to maintain it. I  
19 would not like to take a dogmatic stand on whether  
20 it should be precisely 7 per cent or not, but I do  
21 adhere to the principle that there must be adequate  
22 liquidity maintained by the banks.

23 COMMISSIONER BROWN: Is it fair to  
24 interpret from what you say that you agree there  
25 is merit in having a standard beyond which the Bank  
26 of Canada can know that the banking system as a whole  
27 will not move, and therefore at which point monetary  
28 policy starts to become effective?

29 MR. McKINNON: If I may comment, Mr.  
30 Brown, I think that monetary policy is always effective.







1                   Undoubtedly, it is helpful to the central  
2 bank to know what concepts the chartered banks have  
3 as to a minimum liquidity ratio; but I do not think  
4 there is quite such an area of absence of information  
5 in this field now as perhaps there was six or eight  
6 years ago, because we have gone through three periods  
7 of monetary tightness, credit tightness, since 1955.

8                   I think the statistics will indicate  
9 that when the banks are committed to the extent of  
10 around 70 per cent, or thereabouts, or very little  
11 more than that, in assets which are not cash or  
12 treasury bills or government bonds, that they do re-  
13 strain their operations quite severely. In fact,  
14 they usually act in advance, because it takes quite  
15 a time to bring about a period of adjustment without  
16 too much inconvenience to the public.

17                  COMMISSIONER BROWN: I was thinking more  
18 in terms of some method of insuring that all the  
19 banks are working to the same figure, on the basis  
20 that if, say, one was working to 7 per cent and  
21 another to 9 per cent, then a movement of cash between  
22 the banks would cause quite a dislocation in the  
23 leverage throughout the system.

24                  MR. McKINNON: Well, if I understand  
25 your comment, Mr. Brown, you are raising a question  
26 as to whether the banks should adhere to a uniform  
27 practice in the long run.

28                  COMMISSIONER BROWN: That is right,  
29 as a minimum.

30                  MR. McKINNON: As a minimum?





1 COMMISSIONER BROWN: Yes.

2 MR. McKINNON: I do not think the banks  
3 have adhered to a uniform concept of minimum liquidity,  
4 but there has been a broad approximation, and I would  
5 think, from the point of view of the operation of  
6 monetary policy, that the aggregates are what the  
7 monetary authorities are interested in and not,  
8 perhaps, so much what one individual bank may do as  
9 compared to another one. I know we have had views  
10 at times which obviously had not been shared by other  
11 banks, but the aggregate average seems to have worked  
12 out pretty much in the line of what one would have  
13 expected. I am speaking now in a little broader  
14 context than the secondary reserve itself. Banks  
15 must keep reserves over and above that 8 per cent  
16 plus 7 per cent, because they are the minimum, so  
17 the true reserves are those that exist above that  
18 figure, in the sense of flexible things that can be  
19 used.

20 COMMISSIONER BROWN: For this period of  
21 adjustment particularly?

22 MR. McKINNON: Yes, and for normal  
23 operations as well.

24 COMMISSIONER BROWN: There was one  
25 suggestion the Governor of the Bank made which I  
26 think is quite material in this context, but which  
27 you do not mention. That is, consideration may be  
28 given to reducing the averaging period from a month  
29 to a two-week period.

30 MR. McKINNON: I have only mentioned it



1 indirectly. In addressing myself to this subject  
2 I was avoiding the detailed refinement of techniques  
3 and rather commenting on the broad principle involved.

4 If I may refer to my statement, I did  
5 comment, I think:

6 "The proposal here would apparently  
7 be that the average period covered by  
8 the minimum cash reserve requirement  
9 should be shortened, although the  
10 Governor has of course made it clear that  
11 if the period were too short an  
12 intolerable rigidity would result."

13 COMMISSIONER BROWN: He did specifically  
14 suggest two weeks?

15 MR. McKINNON: Yes. I do not wish to  
16 take a dogmatic view in matters of this kind.

17 COMMISSIONER BROWN: Could I rephrase  
18 my question, possibly? Can you see any advantages  
19 in this, or can you see any disadvantages in it?  
20  
21  
22  
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1 MR. McKINNON: I can see one advantage  
2 where the present technique has worked, we think, quite  
3 well. It is a flexible thing. It is not unreasonable.  
4 It is four weeks. Shortening it to two weeks might  
5 bring more precision in the calculations of the central  
6 bank but it would be an awkward thing from the point of  
7 view of the chartered banks. I am not sure that the  
8 advantages the central bank would gain would outweigh  
9 the awkwardness from the point of view of the individual  
10 chartered banks.

11 COMMISSIONER BROWN: You prefer the four-  
12 week cycle to the two-week cycle?

13 MR. McKINNON: The four-week cycle is some-  
14 what easier to operate under than the two weeks. The  
15 banks work closely to the 8 per cent cash ratio. Idle  
16 cash earns nothing. The average is looked at very  
17 closely. Banks realize that they will have wide swings  
18 in their clearings and wide swings in the cash that is  
19 normally available to them. Just as one example, I  
20 think in some cases it is the practice to develop  
21 something a little over the 8 per cent average in the  
22 early part of the four-week period so you may fall a  
23 little below it later on. Under a two-week period we  
24 would probably have to carry more than 8 per cent cash  
25 to be certain we would not go through the minimum figure.

26 COMMISSIONER BROWN: Thank you very much.

27 COMMISSIONER GIBSON: Mr. McKinnon, I might  
28 ask you a few rather general questions about your views  
29 on monetary policy. We have had a good many briefs, two  
30 of them from other bank presidents, in which views have







1    been expressed as to the function of monetary policy.  
2    Do you regard it mainly as a short-run stabilizer, that  
3    is, a technique for moderating the ups and downs of  
4    business, or as a provider of a desirable climate for  
5    efficiency in the growth of the economy. Would you care  
6    to talk about that?

7           MR. McKINNON: Mr. Gibson, that is a very  
8    broad question. This, of course, goes back into the  
9    old concept of the purposes of currency. I am afraid  
10   that the monetary policy has to do a multiplicity of  
11   jobs. We like to look upon currency as something which  
12   will retain value. In the last quarter of a century  
13   we have not been altogether reassured that it does.  
14   But that undoubtedly is one of the underlying problems  
15   that arises in the minds of our monetary authorities,  
16   that they do not want to create too much currency that  
17   will debase the value of the dollar. That is a long  
18   range consideration.

19           COMMISSIONER GIBSON: Perhaps I should put  
20   the question more specifically. Some people say that  
21   monetary policy should simply be trying to find out the  
22   ups and downs in the short business cycles the best it  
23   can. Other people say that the lags in response to  
24   monetary policy are such that you cannot be too sure  
25   if it will be very effective in this way, and that it  
26   is more important to take a bit longer view and ~~try to main-~~  
27   tain a climate that is encouraging to growth and  
28   efficiency. Efficiency, of course, includes the idea  
29   that money retains some reasonable value.

30           MR. McKINNON: I certainly would agree with



1 the latter part of your statement, that to maintain the  
2 climate is the important thing. I can only speak from  
3 my own experience and I do not profess to be an expert  
4 in this field, but to attempt to use monetary policy to  
5 iron out short cycle periods would impose impossible  
6 demands on those trying to exercise this, for nobody  
7 is gifted with sufficient insight to know what will  
8 happen six months, one year or two years hence.

9 I think the broad climate is the important  
10 thing to maintain.

11 I also think experience has indicated -- and  
12 others who are much more knowledgeable in this subject  
13 than I have given evidence in past hearings before the  
14 Banking and Commerce Committee on this -- that monetary  
15 policy can be effective in some areas and not in others.

16 As we know, in the past monetary policy during  
17 periods of very severe depression, caused by problems of  
18 international trade or other basic problems, has not  
19 been altogether effective in stimulating increased  
20 economic activity.

21 THE CHAIRMAN: Mr. McKinnon, would you mind  
22 speaking a little bit louder. The acoustics are not  
23 good in this room and there are quite a number of  
24 people who would like to hear you.

25 COMMISSIONER GIBSON: In talking about lending  
26 policies of the banks and the degree to which they can  
27 reasonably be expected to respond to monetary policy,  
28 you put a good deal of emphasis, particularly in your  
29 statement this morning, on the desirability of gradual  
30 changes and not abrupt and sudden adjustments.







1 You also put a fair amount of emphasis on  
2 the desirability of some kind of a signal when a  
3 substantial change is required. How should lending  
4 policies respond or should they respond at all when  
5 there is not any strong signal but when bank liquidity  
6 gradually declines as a result of central bank policy,  
7 when there is a gradual increase in loans? When do you  
8 see the lending policies changing under these conditions?  
9 What I am endeavouring to get at is: do you think there  
10 ought to be quite a reduction in liquidity before there  
11 is a change in the lending policy?

12 MR. McKINNON: Not necessarily. The trend  
13 is the significant thing. I think that any bank which  
14 observes its loans increasing and its liquidity position  
15 gradually decreasing tends to adjust itself almost at  
16 once or within a very short period of time by being  
17 a little more conservative as to the magnitude or  
18 extent to which credit might be extended by that  
19 particular bank, because all business seems to be done  
20 and, in fact, is done on the basis of forecasting and  
21 planning and banks are no exception to this rule.

22 If, for example, we were to see our loans  
23 increasing and our cash reserves not increasing, and our  
24 liquidity ratio therefore declining, you would tend to  
25 gradually apply the brakes with increasing effect as  
26 time went on. That is how the period of adjustment  
27 comes about.

28 COMMISSIONER MACKINTOSH: Would there not  
29 be an intermediate step in which you would reduce your  
30 holding of securities to repair your liquidity?



1 MR. McKINNON: Yes, there would be. That is  
2 implicit in what I said, that as our liquidity ratio  
3 declines we would sell securities to finance increases  
4 in loans. There are other influences operating on  
5 banks too. During such a period interest rates tend  
6 to rise, prices of bonds tend to decline, and to sell  
7 bonds, of course, involves losses and no one wants to  
8 take losses if it can be avoided. Sometimes you must  
9 in the long range interest, but you operate so as to  
10 minimize losses if you can.

11 COMMISSIONER MACKINTOSH: As I understand  
12 your answer to Mr. Gibson's question, it is that while  
13 this process of selling some securities is going on you  
14 are at the same time becoming more conservative in your  
15 lending policy; and that this goes on continuously?

16 MR. McKINNON: Yes.

17 COMMISSIONER MACKINTOSH: You do not wait  
18 until you feel your security/<sup>portfolio</sup> has gone down to a minimum  
19 limit and then turn your attention to loans?

20 MR. McKINNON: No; that is not the case. If  
21 I may explain, when I used the word "conservative" I  
22 did not mean in the way of appraising creditworthiness.  
23 We cannot wait until such an extremity, for there would  
24 be such a broad change in relation with all borrowing  
25 customers that it would not only be damaging to them  
26 but to the bank as well. The bank ought to try to  
27 maintain within itself sufficient flexibility to take  
28 care of necessitous needs throughout the country.

29 COMMISSIONER GIBSON: So that you see this  
30 as a fairly smooth process? This is what you mean by







1 the "gentleness of adjustment" in the closing phrases  
2 of your statement, that there is a gradual tightening  
3 rather than a very sudden one?

4 MR. McKINNON: Yes.

5 COMMISSIONER GIBSON: Some people who have  
6 appeared before us have argued that you do not get  
7 much response in real decisions, that is spending  
8 decisions, unless there are quite marked changes in credit  
9 conditions, that is unless interest rates and availability  
10 in credit change very considerably. I take it you would  
11 not support this kind of view?

12 MR. McKINNON: Not to that extreme. We have  
13 had three periods of credit stringency in Canada since  
14 1955: one in 1956, one in 1959, and one this year. These  
15 have arisen from different origins and different sources.  
16 There is a certain experience shown statistically as to  
17 the degree of response, the time lag, and so on. I  
18 think it runs between four and six months from the time  
19 the restrictive measures are initiated until the bank  
20 loans level off or begin to decline. I think to have a  
21 shorter period of adjustment could do a great deal of  
22 harm to business in general throughout the country.

23 COMMISSIONER GIBSON: You have indeed  
24 emphasized the need for a lag in the adjustment of  
25 lending policies. That is your central point, I would  
26 think. What happens, as Dr. Mackintosh was saying, when  
27 prior to any substantial adjustment in lending policies  
28 there is a sale of securities, sometimes short but  
29 sometimes longer securities? Do you have any particular  
30 views about the consequence of these sales, not about





1 the banks' attitude about selling securities but about  
2 what happens as a result of these sales? In other words,  
3 if the central bank wants to keep bank deposits from  
4 rising, this can be achieved just as well by the banks  
5 selling securities. What happens, of course, is that  
6 the sale of a security takes liquidity away from some-  
7 body else and this spreads through the economy in the  
8 form of less liquidity and higher interest rates. Do  
9 you think this is an effective process? In other words,  
10 would you be prepared to say it is as effective or  
11 that it is less effective than a restraining lending  
12 policy?

13 MR. McKINNON: Well, Mr. Gibson, it seems to  
14 me that the two are related. If we do have a period  
15 of credit restraint or credit tightness, whatever one  
16 chooses to call it, initiated by the monetary authorities  
17 for very good reasons, many things have to happen at  
18 the same time. Interest rates will tend to rise.  
19 Securities will tend to be sold whether it is by banks  
20 or individuals. In my opinion a short time will elapse  
21 before the banks will be restrained, and I think all  
22 these consequences are indivisible. Does that answer  
23 the question or have I missed part of it?

24 COMMISSIONER GIBSON: No, I do not think so.  
25 This is the way, of course, the effects of monetary  
26 policy now work themselves out to the near-banks, which  
27 you have talked about at some length, through the sale  
28 of securities by the banks.

29 MR. McKINNON: Yes. Of course, the impact  
30 of central bank policy / on the near-banks is bound to lessen as they grow in size.







1 relative to the chartered banks.

2 COMMISSIONER GIBSON: Oh, yes.

3 COMMISSIONER LEMAN: Mr. McKinnon, I have  
4 a broad question to ask you too. Could you, using a  
5 wide brush, broadly describe for us the major trends  
6 that are observable in the way that the chartered  
7 banking system performance has changed over the years,  
8 let us say, in the post-war period, and tackle it in  
9 the context of the two main recommendations of the  
10 submission that the Canadian Bankers' Association has  
11 made relative to the lifting of the 6 per cent ceiling  
12 on bank interest rates and the ability to take mortgage  
13 security for loans? Where are the chartered banks headed  
14 with all this? But take a look at the past before you  
15 take a look at the future, for this is not a static  
16 thing we are looking at. It is a flow.

17 MR. McKINNON: Yes, Mr. Leman, it is a flow.  
18 I think Mr. Rasminsky, in his evidence, said his  
19 objectives were eternal. . I think ours are perhaps  
20 a little more immediate. But there has been a constant  
21 evolution in the operations of banking in this country  
22 over the years. I suppose it is not unfair to say that  
23 in the early days the country was so short of working  
24 capital that it became the purpose of the banks to collect  
25 all the deposits they could in order to finance current  
26 business.

27 I believe Canada is still short of capital  
28 of a different kind but deposits have grown very  
29 substantially. The banks have become conditioned to  
30 lending on mortgages through the National Housing Act,





1 rather long-term mortgages. Many of them, however, have  
2 had experience / in their pension funds in lending on conventional  
3 mortgages which are usually available on an amortized basis  
4 in monthly instalments over a period of 15 to 20 years.  
5 It does not seem at all unreasonable that the banks  
6 should gradually put some of these deposits into  
7 conventional mortgages.

8 It is one thing to make a recommendation that  
9 the banks should be empowered to do it, but it is quite  
10 a different thing to envisage the extent to which the  
11 banks could do it within any given period of time. I  
12 think the progress would be quite slow but I think it  
13 would be a desirable thing for the banks to have  
14 authority to make such loans.

15 We find for ourselves that we can make such loans  
16 through our pension fund /safely. We know that they are rather more liquid than  
17 the longer-term National Housing Act loans. We believe  
18 that there is a certain gap in the availability of  
19 mortgage money on established housing throughout the  
20 country. I think it would be desirable to have this facility.  
21 I do not believe it would be as economical in the national  
22 interest /however, if institutions outside the banks were able  
23 to gain a greater revenue and pay a higher rate of  
24 interest on deposits than the chartered banks could do  
25 over a longer period of time. I think there will always  
26 be a considerable difference in the nature of assets in  
27 the commercial banks as compared with other organizations  
28 such as trust companies and credit unions, but I think  
29 there is an area there where the chartered banks could  
30 operate successfully and beneficially not only for the







1 public at large but in due course for the savings  
2 depositors as well.

3 COMMISSIONER LEMAN: In your submission you  
4 say, if I may quote one sentence on page 6:

5 "Any realistic assessment of the present  
6 situation must lead to the conclusion that  
7 the considerable network of competing  
8 financial institutions is now well establish-  
9 ed and is here to stay."

10 MR. McKINNON: Yes.

11 COMMISSIONER LEMAN: What I am wondering  
12 about is that the removal of the 6 per cent ceiling and  
13 the extra flexibility this would give the banks at both  
14 ends of the operation, that is in competing to attract  
15 funds from the public and in putting out these funds  
16 to work in broader fields, and this touches on the  
17 ability to take mortgage securities, -- I am just  
18 wondering what the competitive position of these other  
19 financial institutions, which you say are here to stay,  
20 would be?

21 What would be the factors which would enable  
22 them to compete? What is it?

23 They would not be in any better position to attract  
24 funds than the banks. They may have been in the past  
25 while the interest rates were high in relation to what  
26 the banks could do.





1 MR. McKINNON: I think part of the answer  
2 rests in the nature of the business the other insti-  
3 tutions choose to do. The chartered banks are both  
4 savings banks and commercial banks. We are engaged in  
5 commercial lending; that is fundamental in our business.  
6 We therefore have to maintain a certain liquid ratio  
7 to take care of commercial loans. We are not in quite  
8 the same position to commit all the assets of the  
9 chartered banks as others might be, to the higher yielding  
10 and longer term assets, and I think that they will  
11 continue to have a place of their own, that they will  
12 continue to grow. I think some of the figures that I  
13 have given in this brief indicate a very rapid rate of  
14 growth.

15 I think if the banks were authorized to  
16 engage in mortgage lending and if the powers to do  
17 business by the banks in general were broadened, the  
18 other institutions will grow but perhaps not at the  
19 same striking rate in relation to the chartered banks  
20 as we have seen in the last five years. In the last five  
21 years their deposits have grown about 100 per cent,  
22 and those of the chartered banks about 20 per cent.

23 I think if these powers to the chartered  
24 banks were broadened that the banks may be able to  
25 grow relatively a little more than they have done in  
26 the past.

27 COMMISSIONER MACKINTOSH: You are saying that  
28 a man doesn't grow as much as a boy!

29 MR. McKINNON: I think also one of the impacts,  
30 Dr. Mackintosh, would be -- if the banks engaged in







1 | conventional mortgage lending, although one never knows  
2 | what the circumstances will be at the time - the probable  
3 | impact would be a reduction in the rate of interest of  
4 | conventional mortgages.

5 |         COMMISSIONER MACKINTOSH: It is your  
6 | expectation that if it were made permissible the growth  
7 | of mortgage loans by the chartered banks, you expect,  
8 | would be rather gradual and not sudden. Would this,  
9 | do you think, apply both to conventional mortgages on  
10 | house properties and conventional mortgages on commercial  
11 | properties?

12 |         MR. McKINNON: Yes, the gradual growth would  
13 | apply to both, Dr. Mackintosh, in my opinion. There  
14 | would certainly be mortgage lending on commercial  
15 | properties, but I think it would be a rather discriminating  
16 | type of lending, we would be rather careful of the  
17 | credit risk involved here.

18 |         I do have some figures indicating the aggre-  
19 | gates of mortgage lending in recent years. The total  
20 | on conventional mortgage loans made in 1961 was 633  
21 | millions and the total of NHA mortgage loans was one  
22 | billion, 357 millions, so the conventional mortgage  
23 | loans are about half the amount of the NHA loans.

24 |         Now, of this 633 millions, there is a division  
25 | almost equally; about 300 millions in existing  
26 | residential loans and 333 millions in new residential  
27 | loans, so one can see easily from that that the growth  
28 | would have to be a gradual thing.

29 |         COMMISSIONER MACKINTOSH: This works in two  
30 | different directions; if you were enabled to take





1 mortgage securities for some business loans, I imagine  
2 the banks could make some inroads into the field of the  
3 Industrial Development Bank and some other institutions,  
4 which are willing to make somewhat riskier loans because  
5 they can take more security in offering conventional  
6 house mortgages and moving into the field of the  
7 insurance, trust and loan companies.

8 I notice one point in your submission, at the  
9 end of the paragraph which begins on page 7, and you  
10 say there that Mr. Towers in his 1954 statement indicated  
11 at the same time that in his opinion the holdings of  
12 residential amortized mortgages have not been an  
13 important element in the difficulties experienced in  
14 the United States. You contemplate that conventional  
15 mortgages would be amortized?

16 MR. McKINNON: On housing, yes; it is quite  
17 a common practice. I think that has made a vast change  
18 in this whole idea of mortgage lending; it is payable  
19 on a monthly basis and amortized over a period of, I  
20 believe it is, fifteen years now. It has strengthened  
21 the safety of these loans a very great deal.

22 COMMISSIONER MACKINTOSH: It is part of the  
23 agreement as far as conventional loans are concerned.

24 MR. McKINNON: Yes.

25 COMMISSIONER MACKINTOSH: Which are made, I  
26 gather, for five years?

27 MR. McKINNON: They are drawn for five years,  
28 but they are made payable on the basis of fifteen  
29 years.

30 The problem, I think, in the years gone by,







1 many years ago, on conventional loans was that the  
2 mortgage would be drawn for a given period of years  
3 for the original amount and there would be no payments  
4 on it, which was not -- as it turned out -- to the  
5 advantage of either the borrower or the lender.

6 COMMISSIONER MACKINTOSH: Thank you very  
7 much.

8 COMMISSIONER LEMAN: Mr. McKinnon, if I might  
9 quote another sentence in your submission -- and this is  
10 on page 2 -- you say:

11 "If this is the case, it would seem that the  
12 general terms or conditions upon which they  
13 are permitted to do business should be  
14 essentially the same" -

15 That is, all financial institutions --

16 "and that the limitations imposed on banks  
17 which restrict them from offering all types  
18 of service of a banking or fiduciary nature  
19 should be removed."

20 Do I read an implication in there that you  
21 would visualize a bank even getting trust company  
22 powers, engaging in the trust business? You nodded  
23 yes?

24 MR. McKINNON: Yes, that is what we intended  
25 to convey by the use of the word "fiduciary". My  
26 view is that the wider the area of competition among  
27 financial institutions the more beneficial it will be  
28 for the country and for all the companies engaged in  
29 this particular field.

30 The trust companies, of course, are engaged





1 in a great many activities that are under sanction by  
2 the Act itself. If the banks had powers to do all the  
3 business of a trust company nature -- of which mortgage  
4 lending is one -- they may or may not exercise them all,  
5 but they might provide facilities, perhaps, in areas of  
6 the country that are not too well served, because the  
7 trust companies are more prominent in the larger centres,  
8 whereas the chartered banks are represented throughout  
9 the whole country.

10 COMMISSIONER LEMAN: Well, it seems to me  
11 that this is basic to the outlook for the chartered  
12 bank system as a whole. What do you see would be the  
13 desirable trend in the whole complex of financial  
14 institutions that the country has? Do you see that  
15 it would be best if some of them should be regional  
16 in character while the chartered banks are national  
17 in character, most of them, and some of them could  
18 try to specialize in a particular field, while some  
19 of them -- if your recommendations were to be followed  
20 -- would have provided a complete and broad service  
21 that could take care of the customer's entire needs  
22 in the financial field.

23 MR. McKINNON: I think the greater  
24 an area of competition the better it is for the  
25 country and also, strangely enough, I think it is  
26 better for the other companies too, because competition  
27 sharpens up their organizations, and I am quite  
28 satisfied that trust companies and other organizations  
29 are going to continue to grow and expand.

30 If all the banks were given additional





1 powers to engage in trust company activities, this ability  
2 of other companies  
3 /would continue to be so for the reasons I mentioned  
4 earlier, because banks -- as commercial lending  
5 organizations -- are required to carry a certain amount  
6 of liquidity and must be prepared to provide a service  
7 facility throughout the communities in which they  
8 are represented.

9 By giving the banks powers to engage in  
10 fiduciary activities, it may or may not mean that they  
11 would all do it. It may mean that they would arrange  
12 with the trust companies to administer work that  
13 they would negotiate through their branch system, or  
14 that they wouldn't engage at all in that field, but I  
15 think that the broader the powers, the more likelihood  
16 of effective competition throughout the whole country.

17 Part of my thinking is based on the facilities  
18 in other countries. I believe that the British banks  
19 are incorporated under the Joint Stock Companies Act --  
20 there is no separate Bank Act there -- and they have  
21 extremely wide powers.

22 COMMISSIONER LEMAN: Well, I personally am  
23 struck by the fact that we have not had a large inflow  
24 of new banks started in the last 20 years, and I am  
25 wondering if it would not be desirable that the field be  
26 opened to new entrants somehow, and in our discussion  
27 with the general managers we got the impression they  
28 felt it would be very hard for a new bank to get started  
29 in Canada that doesn't have the branch network  
30 that the existing institutions have, which is a key  
factor in the development, and so I am wondering what



1 | your thought is about the possibility of the growth in  
2 | numbers of institutions through specialization, or  
3 | through the possibilities that the regional aspects  
4 | would give them in getting well established in a corner  
5 | of the country, so-called?

6 | MR. McKINNON: I think that the creation of  
7 | a new organization in any business depends entirely on  
8 | the profitability of the business.

9 | Any company or any group of people contem-  
10 | plating establishing a bank in Canada has to look at  
11 | the capital investment involved, the probable profit  
12 | that may be made from it, and weigh that in relation  
13 | to other fields of endeavour.

14 | If financial organizations became more  
15 | profitable there would be more incorporations in the  
16 | area. I think that applies to all types of financial  
17 | organizations, not to just banks, but also as it does to any  
18 | other type of business, and if the profit to be gained  
19 | does not warrant the capital expenditure then, of course,  
20 | there will not be expansion.

21 | COMMISSIONER MACKINTOSH: Pursuing that a  
22 | little further, Mr. McKinnon; you would contemplate  
23 | that if authorized the banks might expand into  
24 | fiduciary business, you say, in certain areas of the  
25 | country. Would you also expect a trend whereby trust  
26 | companies and perhaps some other financial institutions  
27 | would extend further and further into the banking  
28 | business?

29 | MR. McKINNON: That is quite likely, quite  
30 | possible. They have done so to an extent in the last





1 dozen years.

2 COMMISSIONER MACKINTOSH: So, we might say  
3 that in another decade or two there may be a large  
4 number of fairly similar institutions, some of which  
5 would be more trust companies than banks and some of  
6 which would be more banks than trust companies?

7 MR. McKINNON: That is quite possible.

8 COMMISSIONER MACKINTOSH: But all would be  
9 both. Do you think this is a desirable development?

10 MR. McKINNON: Yes, I think so. I think  
11 that the more competition there is in the field the  
12 better it is for the customers and the more effective the  
13 institutions themselves become.

14 COMMISSIONER MACKINTOSH: Do you think this  
15 might, for example, reduce the number of trust companies  
16 or, at least, slow up the entry into that field?  
17 There have been more trust companies organized in recent  
18 years than there have been banks, and if you slow up  
19 the entry into the trust company field, it is a bit of  
20 a calculation as to whether you have got more  
21 competition or not.

22 I have a little difficulty with this concept  
23 of every financial institution becoming a sort of  
24 department store; not all operating in the same depart-  
25 ments, but all operating throughout the whole financial  
26 field. Is this the sort of thing you see ahead?

27 MR. McKINNON: It is rather difficult  
28 to prognosticate what may happen a few years hence,  
29 and I would rather doubt that many new financial  
30 organizations would open branches on the scale that the





1 Canadian chartered banks have done.

2           The profit in a financial business has to  
3 be made where you can get the volume, and the volume  
4 is obviously in the larger centres and that is where  
5 you would see the normal expansion of institutions of  
6 that kind. So, I don't think by enlarging the powers  
7 of the banks that it will mean that the activities of  
8 other institutions will be curtailed. I think they will  
9 continue to expand; I think they should and I think they  
10 will be able to. I think that they do offer and will  
11 continue to offer a degree of service that is perhaps  
12 somewhat more specialized than the chartered banks.  
13 If they, of course, engage in commercial lending and  
14 assume the obligations as well as the activities of  
15 the chartered banks, then they would be on about the  
16 same footing in the competition.

17           COMMISSIONER MACKINTOSH: There may be others,  
18 but I see two possible patterns; one of which is the  
19 extension of the powers of a variety of financial  
20 institutions so that they all overlap a bit, the ones  
21 we have been talking about; and the other is the  
22 development of a considerable variety of specialized  
23 institutions all working in different fields and having  
24 some overlapping with each other through  
25 the markets. I don't know enough about it, but I  
26 think there is more of this pattern in the British  
27 system. I am just wondering which is the better  
28 pattern to work towards?

29           MR. McKINNON:           Some of that pattern is  
30 emerging here, too, but, of course, I think we must





1 remember that in the British system this particular  
2 pattern has emerged in a condition where there are no  
3 restrictions on any of these companies; they can go  
4 ahead and incorporate under the Joint Stock Companies  
5 Act and provide whatever service they feel that they  
6 can do profitably and usefully, and that has created  
7 in my opinion a diversity in the system that exists  
8 there, together with the fact that Britain is a great  
9 international trader as well.

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1 THE CHAIRMAN: Well, in Great Britain  
2 is there not, in fact, a considerable degree of  
3 specialization? Although they may have the widest  
4 powers to engage in almost any type of financial  
5 business, there being very limited legal restrictions,  
6 nevertheless, are they not, in fact, inclined to  
7 specialize perhaps more than we do in this country?

8 MR. McKINNON: Yes, I believe that is  
9 true, Mr. Chairman, and I think that the freedom  
10 to compete has helped to create that system.

11 THE CHAIRMAN: Yes.

12 MR. McKINNON: They are in business  
13 to make money, and to offer facilities from which  
14 they can profit. Many of them feel that by offering  
15 a specialized type of service they can do better  
16 than by offering more generalized services. There  
17 is no reason why we should not see the emergence of  
18 that type of financial organization in Canada.

19 THE CHAIRMAN: On the other hand, what  
20 is wrong with the "department store"?

21 MR. McKINNON: Of course, that is what  
22 I am rather advocating, but I do not think we would  
23 be able to monopolize the market.

24 THE CHAIRMAN: Suppose there was a  
25 statute of some kind which provided for various  
26 departments -- departments of business? If an  
27 institution engages in the deposit business, for  
28 instance -- and that is regarded generally as banking,  
29 although we are still wondering what definition has  
30 to be given to "banking", because it seems to be a







1 rather vague term -- that would be one item. If an  
2 institution enters into that sort of business on  
3 a reasonably big scale then it would be reasonable  
4 to think that it would have to comply with the  
5 regulations that are appropriate to that type of  
6 business. The trust type of fiduciary business would  
7 involve other types of regulations. Suppose you had  
8 five or six departments of the financial business  
9 provided for, and that any company could apply for  
10 the right to engage in any one or more of those  
11 departments, and be subject in each department of  
12 their business to the restrictions and the legal  
13 provisions that would apply to that particular type  
14 of business, would you consider that to be a good  
15 thing? That would provide for the most complete  
16 competition that you have in mind, and at the same  
17 time it would provide for the same type of regulations  
18 to apply to all companies that engaged in the business  
19 of any particular department.

20 MR. MCKINNON: Yes, and, of course,  
21 it is the case that banks elsewhere -- in countries  
22 such as Britain, the United States and others as  
23 well -- do have much broader powers to do business  
24 than do the Canadian chartered banks. But, I think,  
25 Mr. Chairman, that probably the determining factor in  
26 the end would be the skills of management. Certainly  
27 it is true that any organization that can introduce  
28 superior management skills will do rather better  
29 than others, and I think that is the condition that  
30 has created the diversity of organizations that can





1 | be found in other countries.

2 |           THE CHAIRMAN: I suppose the main  
3 | considerations we are concerned with are whether  
4 | organizations carrying on the same kind of business  
5 | should be subject to the same kind of restrictions,  
6 | whereas, perhaps, that is not so now -- at least,  
7 | that seems to be your contention from a reading of  
8 | your submission.

9 |           MR. McKINNON: Yes. If I may, Mr.  
10 | Chairman, I would like to refer to the word "restrictions"  
11 | with some degree of diffidence because the less  
12 | restricted organizations are the more effective  
13 | they will become.

14 |           COMMISSIONER MACKINTOSH: You would  
15 | like the same lack of restrictions?

16 |           MR. McKINNON: I think there would  
17 | have to be certain house rules, and that they will  
18 | have to be abided by.

19 |           THE CHAIRMAN: There are certain ground  
20 | rules that apply in various ways to different kinds  
21 | of corporations.

22 |           MR. McKINNON: Yes, and they have to  
23 | be established in the public interest.

24 |           THE CHAIRMAN: They would have to abide  
25 | by the ground rules that would be enforced by the  
26 | central bank, but there might be other ground rules  
27 | that need not be touched by the central bank directly  
28 | at all.

29 |           MR. McKINNON: I remember that during  
30 | the 1944 revision of the Bank Act the late Mr. Hanson







1 referred to the impact of the Bank Act on the banks  
2 as making them the most cribbed, cabined and confined  
3 institutions in the country.

4 COMMISSIONER MACKINTOSH: May I go in  
5 a little different direction from this general area?  
6 There is in this country a very considerable variety  
7 of links between banks and trust companies, ranging  
8 all the way from stock ownership to common directors.  
9 There are traditional relationships, and so on, which  
10 have been a little hard to handle. If you move in  
11 this direction of giving considerable scope and  
12 common powers to these various companies does that  
13 not mean that these links become essentially links  
14 between banks which raise more serious questions  
15 than links between a bank and a trust company?

16 MR. McKINNON: I am not at all sure  
17 that that would be the case, Dr. Mackintosh. These  
18 links to which you refer have existed for some time.  
19 It has been customary for banks and trust companies  
20 to have certain affiliations represented by directors  
21 on each others' boards, and so on. That certainly  
22 has not stopped the trust companies from moving into  
23 the banking field.

24 In the first place, the responsibility  
25 of the management of the trust company must be to  
26 serve the interests of its clients and shareholders.  
27 No representation on this board that tended to dis-  
28 courage it from doing that job would be a suitable  
29 representation.

30 I think the evidence we have found of their  
own expansion in the last dozen years demonstrates the  
fact that managements have acted independently serving  
their own interest, and not referring to the interests



Toronto, Ontario

of any particular director.

I do not know whether that is universally true, but it is generally true. There has been quite a lot of evidence on that subject.

COMMISSIONER MACKINTOSH: If you have this development of the banking and trust company business, with the trust companies going further into the banking business, and you consider these links as advantageous, and that it is not necessary to disrupt them, is there any reason why banks should not hold stock in other banks? You are all going to be banks together.

MR. McKINNON: That brings us back to the various areas of specialization to which you referred earlier, and also to my comment about superior management skills. I think that the companies that specialize in a certain area do tend to develop a particular facility. I do not believe that the evolution of financial institutions in Canada has led to any lessening of competition. Competition has been greatly intensified. I see no reason why that should not happen in the future. I think it is a desirable thing that it should.

COMMISSIONER MACKINTOSH: Competition among a few, however, can differ from competition among a large number of institutions. I am not suggesting it does not exist, but it follows different patterns.

MR. McKINNON: It is more intensified.

COMMISSIONER MACKINTOSH: That may go to the point where it has to be controlled.

MR. McKINNON: I would hope that the judgment of the managements of the institutions would not carry them to excesses. There are automatic built-in governors.





1 The area of management of every bank must do a job that  
2 is satisfactory to its shareholders each year too.

3 COMMISSIONER MACKINTOSH: Another way of  
4 looking at this is this; the evidence is that entrance  
5 into the banking field as it now stands is very  
6 difficult, and the prospects of a profitable survival  
7 seem not to be very great for any small bank which  
8 specializes, and which, for want of a whole branch  
9 system, cannot give the full range of banking services.  
10 We do not seem to have developed any of those, at any  
11 rate, but with this overlapping of financial institutions,  
12 would you contemplate that the best way in the future  
13 of getting some additional banks would be probably that  
14 of getting additional trust companies and finance  
15 companies, and letting them grow up into the banking  
16 business?

17 MR. McKINNON: There is no reason why they  
18 should not. There is only one reason why there have not  
19 been more banks incorporated in this country, and that  
20 is that there has not been much possibility for  
21 profitability especially when you take into account the  
22 amount of capitalization that is necessary to establish  
23 a branch banking system. But, if the profits are  
24 adequate then you will see new banks incorporated.

25 COMMISSIONER MACKINTOSH: I can see that  
26 there would be a long unprofitable initial period.  
27 Even if they can expect to arrive at a pretty profitable  
28 basis in 15 or 25 years that intervening period of  
29 unprofitability is pretty intimidating. Is that not  
30 the situation?







1 MR. McKINNON: Yes, it is, and that is the  
2 case, I suppose, with respect to existing banks too.  
3 When we establish new branches and expand internally  
4 we have to recognize that there will be a period of  
5 losses for every new unit established, but none the less  
6 -- I am coming to your basic point -- if the profits  
7 after having become established are sufficient or  
8 adequate then other new banks would be incorporated.  
9 The reason why others have not been incorporated is because  
10 when comparing the investment of capital in the banking  
11 field to the long initial period of loss that has to be  
12 taken -- a manufacturing company must take loss too  
13 when it builds a plant -- it is usually seen that there  
14 are more attractive areas for investment elsewhere.

15 COMMISSIONER MACKINTOSH: It is that initial  
16 period. Your shareholders would be selling their shares  
17 if the profitability of the banking business were  
18 falling. That is true. The one observable thing  
19 is that new people are not going into the banking  
20 business.

21 MR. McKINNON: There have not been new  
22 companies established in the automobile industry either.  
23 There has been a lot more bold competition there.  
24 It is very intense. I think that could be said about  
25 many industries, including the chemical industry.

6 COMMISSIONER MACKINTOSH: The extension of  
7 the banks into the lending fields in which they are not  
8 active now, and even into fiduciary business, would  
9 tend to provide more business for their smaller and  
1 less profitable branches?





1 MR. McKINNON: I would hope so.

2 COMMISSIONER MACKINTOSH: This is in accord

3 with your suggestion that if there was permission to go  
4 into the trust company business you would not go into  
5 it everywhere but probably only in those places where  
6 you felt there was a lack of service in that field.

7 This might, in the case of small town branches at any  
8 rate, give you an advantage, just as the Central Mortgage  
9 and Housing Corporation hoped to get advantage in its  
10 mortgage business from your branch system in the areas  
11 which the insurance companies did not serve -- the small  
12 areas which they did not serve as fully or directly as  
13 they did the big areas. This would fit into the same  
14 pattern?

15 MR. McKINNON: It would, but I would be a  
16 little less precise than the way you have suggested it.  
17 I think the powers should exist and then let competition  
18 take its course. I cannot forecast what banks would  
19 provide what services; whether the banks would do it  
20 individually themselves or whether they would make  
21 arrangements with a trust company to take on the work  
22 that their branches would generate. That would be a  
23 matter for the appraisal and judgment of each individual  
24 institution, but I think if the power existed to do it  
25 then I think the additional competition in the field  
26 would involve additional facilities.

27 COMMISSIONER MACKINTOSH: If we were to  
28 recommend that the power of the banks should be  
29 enlarged to this degree someone will ask: What do you  
30 expect to result from this recommendation? In that





1 event we do not want to say: "Mr. McKinnon cannot tell  
2 us".

3 MR. McKINNON: I hate to speak on behalf of  
4 ---

5 COMMISSIONER MACKINTOSH: I know you are not  
6 willing to make any precise predictions, but I just  
7 wanted to explore the kind of thing that might occur.

8 MR. McKINNON: What is suggested here is  
9 not at all an uncommon thing in practically every other  
10 country in the world where banks have  
11 power to engage in that type of business. That has  
12 not detracted from the growth of a variety of  
13 organizations in those countries.

14 COMMISSIONER BROWN: I wonder if I could  
15 put the question a little differently. At the moment,  
16 based on what we understand to be a legal opinion of  
17 section 75 of the Bank Act, the banks have refrained  
18 from directly owning control of trust companies, and  
19 so forth.

20 MR. McKINNON: Yes.

21 COMMISSIONER BROWN: Now, if the banks  
22 were empowered to go into the fiduciary business  
23 do you think it would be more likely for them to  
24 start a trust company of their own, or more likely  
25 that they would obtain complete ownership of existing  
26 trust companies? Which probably would be a more healthy  
27 development?

28 MR. McKINNON: That is not an easy question  
29 to answer because it would depend on what it would  
30 cost to buy an existing trust company. Some banks --





1 and this is a matter of public knowledge, of course,  
2 -- have substantial interests in other trust companies.  
3 I think the degree of interest and arrangement varies  
4 in all these institutions. I think it would depend  
5 entirely on where the commercial advantage would lie.

6 With an established trust company there are  
7 established managerial skills and a great deal of  
8 experience which is not easy to create overnight. On  
9 the other hand, the price might be so high that it  
10 would not pay to consider/go through the period of  
11 organization and development of management. As Dr.  
12 Mackintosh referred to earlier, there would be a period  
13 of unprofitability.

14 I would hesitate to make a forecast. The  
15 only thing I can say is that the wider the field  
16 permitted any given set of organizations then the greater  
17 the competition that will ensue there. It does not mean  
18 that the organizations necessarily are going to make a  
19 lot more money. We naturally hope they will, but  
20 competition might make it difficult to do so. I think  
21 you will have a rather mixed pattern emerging.

22 COMMISSIONER BROWN: Well, some banks are  
23 almost in a position of taking over completely one or  
24 more trust companies now. If that occurred, and one  
25 member of this fairly small group of competing  
26 chartered banks suddenly came up with complete  
27 ownership of an existing trust company, I find it  
28 rather difficult to visualize some of the larger  
29 banks holding back and not starting to develop their  
30 own business. I cannot help but think there would be





1 an intense competition to also acquire existing trust  
2 companies. I do not see how this is going to increase  
3 competition. It may intensify competition among those  
4 in the business, but it is certainly not going to  
5 increase the number in the business.

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1 MR. McKINNON: That may be so. It may  
2 also be some banks might decide it would be more  
3 economical to establish their own trust departments.

4 COMMISSIONER MACKINTOSH: A worrying  
5 presumption in my mind is, when you speak of manage-  
6 ment skills, on the average I suppose you would be  
7 more apt to look for them in the trust companies  
8 which had demonstrated ability by having a large  
9 business?

10 MR. McKINNON: Yes..

11 COMMISSIONER MACKINTOSH: Rather than  
12 in the small ones?

13 MR. McKINNON: May I put the question  
14 in a different sense? If a chartered bank, under  
15 existing legislation, may own 49 per cent of a trust  
16 company, do you see any harm in it owning 100 per  
17 cent?

18 COMMISSIONER MACKINTOSH: Yes, but I  
19 did not say I approved of the 49 per cent!

20 MR. McKINNON: Well, if I may, with  
21 your permission, make another comment: I would like  
22 to go back to the basic premise that the broader  
23 the powers, the greater the competition that will  
24 exist. What is suggested here is something that  
25 has been followed in every other country in the world.

26 COMMISSIONER BROWN: But they started  
27 equal, did they not? They all started competing on  
28 an equal basis. You did not suddenly find large  
29 financial institutions given this power to compete  
30 with other institutions that had not grown to the same





1 extent but had been developed on a more specialized  
2 basis. They all started equal, and all had an  
3 equal opportunity to start with.

4 MR. McKINNON: Yes. That power is con-  
5 sidered to be basic in banks in other countries, the  
6 power to do trust company business.

7 THE CHAIRMAN: Isn't the situation this  
8 at the present time, the institutions are few and  
9 each of them is very large, and they cover, I suppose,  
10 pretty well the whole field. There may be fringes  
11 that have not been exploited, but it is pretty  
12 difficult for a new group of people to break into  
13 that type of business and survive.

14 MR. McKINNON: If the profitability is  
15 adequate I think you will find people engaging in the  
16 field. Usually the fewer the number of institutions  
17 it means that the less the attractiveness from the  
18 point of view of the return on the capital invested.  
19 The fact there is concentration means there is not  
20 as attractive an outlet for capital.

21 THE CHAIRMAN: The trend has been for  
22 amalgamations.

23 COMMISSIONER BROWN: I think that possibly  
24 the implication behind all this is the query  
25 in the minds of some people as to whether there is  
26 really effective competition between the existing  
27 chartered banks in all phases. There is obviously  
28 effective competition in certain things, such as  
29 providing services and opening new branches, and this  
30 sort of thing, but I think there are obviously some







1 questions in some people's minds as to whether there  
2 is effective competition in matters such as interest  
3 rates and so forth.

4 MR. McKINNON: I can assure you, Mr.  
5 Brown, there is this extremely effective competition.  
6 The bank that fixes the highest rate on deposits  
7 sets the pattern for the whole business. The  
8 bank that fixes the lowest rate on loans sets the  
9 pattern there too. That has happened to all the  
10 banks in recent years on several occasions.

11 THE CHAIRMAN: There are just a few  
12 questions, Mr. McKinnon, on Part Two of your sub-  
13 mission. The first point you raise is the provision  
14 in the Bank Act.

15 "That an offering of rights to  
16 shareholders to subscribe to  
17 new shares must be made at a price  
18 calculated under a prescribed  
19 formula which has the effect of  
20 pricing the new shares at the book  
21 value of presently outstanding  
22 shares less undivided profits."

23 You suggest that the result of this is that when  
24 the banks offer new shares it is inevitably at an  
25 abnormally deep discount off market price. I was  
26 rather interested in the reason for this restriction,  
27 in the first place. You suggested it goes back to  
28 the "double liability" feature, and I was not  
29 quite clear in my mind as to how that would lead to  
30 this result.





1 MR. McKINNON: That is an assumption  
2 on my part, because this has been a provision in the  
3 Bank Act for many years. We ourselves presumed it  
4 was related to the "double liability" feature of  
5 bank shares, because it meant the shareholders would  
6 not have to pay a higher price than the book value,  
7 and it did limit their liability. This liability  
8 was eliminated when the note currency  
/was taken over by the Bank of Canada, but this pro-  
9 vision continued.

10 THE CHAIRMAN: At any rate, what you  
11 suggest is that the Bank should be treated as is  
12 any other corporation?

13 MR. McKINNON: Yes. This has been a  
14 matter of discussion for some time. It was raised  
15 informally prior to the provision of the Bank Act  
16 in 1954, but there was not any legislative action  
17 taken at that time.

18 THE CHAIRMAN: What were the main  
19 objections put forward? It is rather difficult  
20 for me to visualize what the objections might be.

21 MR. McKINNON: I think the bankers  
22 themselves approached it with some degree of diffidence  
23 because it is not the way to win popularity with the  
24 shareholders, to suggest this be changed. I believe  
25 it is in the long-run interest of shareholders; I  
26 am convinced of it; but in the short-run interest  
27 the benefits are, of course, obvious.

28 THE CHAIRMAN: The next point you raise  
29 is that you think that provision should be made  
30 for the issue of additional shares and stock option





1 plans for employees and officers. That would be  
2 in addition to the ordinary provision as to the  
3 additional shares being offered pro rata to  
4 existing shareholders, and that further power should  
5 be given. I understand the reason to be that this  
6 would enable you to compensate certain officials  
7 and employees, so that you would attract personnel  
8 of a high calibre, and so on, and also it would  
9 encourage employees to become shareholders.

10 MR. McKINNON: Yes, sir. Presently,  
11 of course, the banks may not provide shares for  
12 this purpose. Other corporations may do so.  
13 We believe there would be a benefit to be gained,  
14 not only by employees and officers but, possibly,  
15 an improved calibre of service by obtaining  
16 a greater identification of officers and employees  
17 with the shareholder interests. If it were possible,  
18 it might not be adopted by all banks, but I think it  
19 would be a beneficial thing to many banks and to  
20 their employees.

21 THE CHAIRMAN: The final point is with  
22 reference to the provision a bank may not contribute  
23 to any pension fund if any part of the fund has been  
24 invested in the capital shares of a bank. Do you  
25 think that limitation should be mitigated?

26 MR. McKINNON: Yes, it would be possible  
27 now with the approval of treasury board, but it  
28 just occurred to me to suggest this be thought of,  
29 because if a bank were to ask the treasury board  
30 for permission it would undoubtedly be a great deal







1 of help to treasury board to have the views of this  
2 Commission.

3 I think too, Mr. Chairman, that although  
4 I believe this was introduced in the Bank Act fairly  
5 recently, this type of thinking went back to the old  
6 days of "double liability" too.

7 THE CHAIRMAN: Yes. You also mentioned  
8 it would be feasible and, you think, desirable to  
9 provide for voting of the bank shares by individual  
10 members of the pension fund in relation to their  
11 relative contributions to the fund. Would that  
12 be complicated?

13 MR. MCKINNON: It has been done in  
14 another industrial corporation that bought a large number  
15 of their own shares and passed on voting rights  
16 to its employees. I would not suggest that any  
17 disproportionate amount be invested in bank shares,  
18 because I think the same provisions about diversity  
19 of investment would be applied there too. Again,  
20 one of the benefits, of course, is to identify the  
21 members of the pension fund with the shareholder  
22 interest, and to pass on voting rights is one more  
23 way of emphasizing it.

24 COMMISSIONER BROWN: Mr. McKinnon,  
25 I would like to go back to something we touched on  
26 much earlier, and I was under the misapprehension  
27 that somebody else was going to follow it up and  
28 so lost the opportunity to do so myself.

29 Your submission -- and you did refer  
30 to it also in talking to the subject very briefly





1 on the question of increased investments in mortgages  
2 by the chartered banks -- you say you do not see any  
3 need, I think you say here:

4 "While it is neither necessary nor  
5 desirable for the effectiveness of  
6 this proposed measure to envisage  
7 any rigid separation of savings  
8 deposits from other deposits in looking  
9 at a bank's over-all operation, it  
10 remains true that savings deposits  
11 in the aggregate are a relatively  
12 stable and long-term element on a bank's  
13 books and it is therefore reasonable  
14 and appropriate that at least a  
15 proportion of these savings deposits  
16 should be invested in relatively  
17 longer-term instruments, particularly  
18 in conventional and other mortgages.

19 You visualize this as being advisable at some time  
20 in the future when mortgages might become a greater  
21 proportion of the banks' assets?

22 MR. MCKINNON: No, I may have created  
23 the wrong impression with that comment. I do not  
24 think it is desirable at all. It has been tried  
25 elsewhere and it has been abandoned wherever it has  
26 been tried -- for example, various states in the  
27 United States -- because this type of thing represents  
28 a restriction on the judgment of the management, the  
29 extent to which you may commit assets in any particular  
30 direction. The Inspector General is in intimate touch







1 with bank affairs, and he will see to it the banks  
2 are managed in such a way as not to jeopardize the  
3 interests of the depositors. To put any rigid  
4 separation on it is not a practical thing. A large  
5 part of deposits in banks are represented by  
6 commercial loans at the present time. There would  
7 be quite a long period or evolution to take its  
8 course before any really significant part of the  
9 savings deposits were represented by mortgage loans.

10 COMMISSIONER BROWN: Would you visualize  
11 the banks waxing hot and cold on this, or each  
12 individual bank, based on the judgment of its  
13 directors and management, would work up to a certain  
14 level and then roll over the funds as they came in?

15 MR. McKINNON: I visualize that  
16 if the banks went into this field they would attempt  
17 to follow a consistent policy. It is one thing  
18 to play with figures on this subject, but if you  
19 thought in terms of 20 per cent of savings deposits  
20 over a period of years being represented by con-  
21 ventional mortgage loans, that would be roughly  
22 \$1.6 billion. With an average maturity of  
23 something over eight years there would be a cash  
24 flow of \$200 million, and that would be rechannelled  
25 into this particular field. As I say, that is  
26 really playing with figures, but it can be related  
27 to the present level of conventional mortgage loans  
28 which run about \$600 million a year, of which  
29 about half is existing residential and the other  
30 half new.





1 COMMISSIONER BROWN: Do we have to think  
2 of a bank branch manager, in times of credit  
3 stringency, reducing working capital loans and granting  
4 mortgage loans?

5 MR. McKINNON: The banks give a very  
6 great deal of thought to that, and this would involve  
7 quite a long, evolutionary process, and it could  
8 not happen overnight. The supply of mortgages  
9 probably is not there, for one thing. But in any  
10 case, the banks must always be prepared to take care  
11 of their established business. If any bank allowed  
12 itself to lose competitively some liquidity compared  
13 to others, it would lose business in that area. I  
14 think that would regulate the matter.

15 THE CHAIRMAN: Thank you very much,  
16 Mr. McKinnon. Your discussion has been very helpful  
17 to the Commission, and we appreciate your attendance  
18 here today very much.

19 MR. McKINNON: Thank you, sir.

20 THE CHAIRMAN: We shall now adjourn  
21 for fifteen minutes.

22  
23 --- Recess.  
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SUBMISSION OF  
BANK OF MONTREAL

APPEARANCES

G. Arnold Hart - President,  
Bank of Montreal.

THE CHAIRMAN: We shall now resume.

We have a submission now from Mr. G. Arnold Hart,  
the President of the Bank of Montreal.

We welcome you to this Commission today --  
although I have noticed you have been sitting here  
for the last few days. We look forward to a dis-  
cussion of the submission you have filed, which  
we appreciate very much.

MR. HART: Thank you very much indeed,  
Mr. Chairman. I can assure you it is a pleasure  
to be here. I have looked forward to this with  
rather keen anticipation.

The Governor of the Bank of Canada  
in his opening remarks, of course, made a very good  
statement, I thought, when he said /that through its exercise of  
preparing for its appearance before the Royal  
Commission the Bank of Canada had certainly learned  
a lot; and I think the President of the Canadian  
Bankers' Association put forward much the same thought







1 in his opening remarks. I would like also to  
2 add my conviction to that, because this has given  
3 us an opportunity in the banking profession to look  
4 at ourselves, to see where we are going and, above  
5 all, to ensure that we are acting and behaving in  
6 the best interests of Canada as a whole. I submit,  
7 therefore, that any statements I may make -- or,  
8 in fact, that have already been made -- are not  
9 motivated by self-interest and, indeed, should not  
10 be motivated by self-interest. We are here to  
11 examine the banking system, <sup>and</sup> the whole financial  
12 system of which we form a part.

13 I will not attempt to summarize my  
14 brief, which you have before you and which I hope  
15 you will find in rather brief terms; but, rather,  
16 I would like to spend a few minutes on banking as  
17 such. Of course, there is no precise definition  
18 of banking. I think we have searched our souls  
19 and thoughts to come up with a precise definition,  
20 but in the nature of the banking profession perhaps  
21 that is not possible. But if I may use the term  
22 pure banking, applied to chartered banks, we do  
23 have the nature of a trust, in that we do accept  
24 deposits from all sorts of people. We mobilize  
25 these deposits which are other people's money and,  
26 in turn, we lend these deposits to others at a profit.  
27 We accept deposits and we pay, you might say, a profit  
28 to the depositor in the rate of interest that we give;  
29 and also, in turn, in lending that money we attempt  
30 to realize a profit over and above our operating





1 expenses.

2 As I have said, there is no precise  
3 definition of banking, and I think I might say here  
4 that the lending of money is not an exact science.  
5 Over the years, of course, we have built up certain  
6 rules of thumb, guide lines, but, again, we cannot  
7 be exact in the day-to-day operations of lending  
8 money.

9 Here, too, I would like to emphasize  
10 that the lending of money is a tremendous responsibility.  
11 It is based on a very close and intimate relationship,  
12 and confidential relationship, with our clients, and  
13 they look to us for our assistance and, I hope, for  
14 our guidance in the conduct of their affairs. Perhaps  
15 if I might use an analogy, it is something like the  
16 relationship of a doctor and his patient. We have  
17 to be very careful in the exercise of the power  
18 we have, and we do have a certain power -- I think  
19 we must admit that. But the exercise of our  
20 banking function : has been based on years of  
21 experience. You cannot make a banker overnight;  
22 you cannot make a money-lender overnight -- if you  
23 want to have a good one.

24 We have seen entrants in the broad  
25 field of banking, in near-banking, and I hope they  
26 will so conduct themselves that the banking profession  
27 as a whole will not suffer. Some are under  
28 investigation; others may follow; but I think we  
29 have to watch ourselves closely at all times in this  
30 very important respect. The strength of the banks







1 as a whole is a very important aspect. I am speaking  
2 of the larger banks and the smaller banks. I am  
3 not talking about the strength of one bank being  
4 greater than that of another, because that would  
5 be wrong. We must look at the banking system as  
6 a whole, and ensure that what we do strengthens our  
7 own position in the financial field.

8 I submit, therefore, we do not want  
9 to take any steps by way, may I say, of tinkering  
10 with the banking system. It has stood the test  
11 of time. We have had our ups and downs, but by  
12 and large the banks have gone from strength to  
13 strength; and I submit this is so because we have  
14 provided a good banking system, based on sound  
15 principles.

16 We welcome such searching investigation  
17 as this Commission is providing to help us keep  
18 abreast of the times; and we must do that if we  
19 are going to continue to perform our function in  
20 the financial field.

21 The banks cannot possibly do all the  
22 business. It is not conceivable that we can, but  
23 we do want to be more effective as time goes on.  
24 We want more flexibility in our operations, and that  
25 has been brought out very forcibly in previous  
26 submissions -- not only flexibility in our operations,  
27 but flexibility in rates. We do handle a great many  
28 loans, and we could handle a great many more if  
29 the rate restrictions were removed and if we  
30 were empowered to take mortgage security, which





1 Mr. McKinnon touched on this morning, and others  
2 prior to him. I submit the taking of  
3 mortgage security is not for the purpose of going  
4 into the mortgage business. In my own opinion we  
5 should be empowered to do it -- and I am thinking  
6 of the smaller commercial borrowers. This would  
7 enable us to take a security, perhaps, in a field  
8 where we have not exercised as great an influence  
9 as we might. I do not mean "influence", but from  
10 the standpoint of performing the function of looking  
11 after the short, medium and, in some cases, long-  
12 term borrowing requirements of clients.



If we could take this mortgage security and also charge reasonable rates of interest, I think we could broaden our influence for the benefit of Canada as a whole. After all, we have a large, and I hope, well-diversified banking organization across the country. We reach many corners of Canada which other institutions cannot touch by virtue of the fact they may be somewhat more restricted in their fields of operation; therefore we have a system which we should ensure that we utilize to the full extent.

It is true that in the matter of mortgage security we would be in a position, perhaps, in outlying areas which are not reached by ordinary mortgage companies or those engaged in that business, to perform a function there by making mortgage loans, as I suggested this morning. But I submit that this should not be too large a part of our business.

I am thinking more of additional powers to take security, as I mentioned, / look after the requirements of smaller borrowers, and larger borrowers too, in the initial stages of their borrowing requirements.

Mr. Chairman, with these few remarks I hope that I may have aroused some questions in your minds and I would be very happy to attempt to answer to the best of my ability any questions you would care to put to me now.

THE CHAIRMAN: Thank you very much, Mr. Hart.

COMMISSIONER BROWN: Mr. Hart, it is obvious from reading your brief that you approve of the 8 per cent cash requirement in its present form. I am not







1 quite clear as to your opinion about the 15 per cent  
2 liquid asset ratio requirement. You do say that you  
3 do not think it should be made part of the legal  
4 operation, and should not be made statutory.

5 You do refer to the fact that you would not  
6 like to see it developed in a way whereby the banks  
7 would provide a captive market for short-term Government  
8 of Canada securities. Do you think it is operating in  
9 that way at all now?

10 MR. HART: No, I do not think it is, Mr.  
11 Brown. We have seen no evidence of that whatsoever.  
12 I merely placed myself on record in this respect that  
13 we should not provide such an opportunity for that to  
14 take place.

15 COMMISSIONER BROWN: How do you see this  
16 secondary reserve requirement operating now? You refer  
17 to the 8 per cent cash requirement acting as a fulcrum  
18 whereby the central bank can directly influence the  
19 chartered banking system by making cash scarce or  
20 otherwise in relation to the requirements of the reserve  
21 ratio as such.

22 Do you see the secondary reserve requirement  
23 acting in somewhat the same way as far as influencing  
24 generally the liquidity of the banking system?

25 MR. HART: Yes, I think it does, Mr. Brown.  
26 I am not suggesting that the secondary requirement of  
27 7 per cent should be removed. I believe it is a  
28 gentleman's agreement and should not be brought under a  
29 statute. It is arranged by discussion between the  
30 Governor of the Bank of Canada and the chartered banks.





1 The point I am trying to make is that rather than  
2 crystallizing this 7 per cent, we should allow for that  
3 flexibility which I would hope would allow reductions  
4 from time to time in this voluntary reserve of 7 per  
5 cent, and certainly not increases.

6 After all, as has been pointed out by previous  
7 speakers, our actual reserves are those over and above  
8 the 15 per cent, the reserves which we can use as a  
9 basis for our loans. Once you get down to 15 per cent  
10 and below that, if that should happen, then your  
11 reserves as such are used up.

12 COMMISSIONER BROWN: The Governor of the Bank  
13 of Canada suggested that it might be useful to have  
14 power to vary this 15 per cent requirement as a technique  
15 of monetary policy. Do you think it would be an effective  
16 technique?

17 MR. HART: I think it would, Mr. Brown.  
18 After all, the Governor does have power to vary  
19 requirements now because this secondary reserve of  
20 7 per cent, as I ~~said~~, is an informal arrangement between  
21 the Governor of the Bank of Canada and the chartered  
22 banks.

23 I would hope, though, that it would not be  
24 in the nature of an increase in the secondary reserve  
25 but rather as a reduction, as circumstances might  
26 dictate.

27 COMMISSIONER MACKINTOSH: You say that the  
28 Governor of the Bank of Canada has this power. You  
29 mean that he has the opportunity to make a new agreement?

30 MR. HART: That is correct, Dr. Mackintosh,







1 to make a new agreement rather than to have the power.

2 COMMISSIONER GIBSON: Mr. Hart, I have a  
3 few questions on the monetary policy side. In your  
4 submission, paragraphs 12 to 16, you point to the  
5 popularity of easy money and you state the importance  
6 of letting the public know frankly and forcefully why  
7 sometimes high interest rates are desirable, and you  
8 also emphasize the importance of balance of payments  
9 as a condition in monetary policy.

10 What do you regard as the main function of  
11 monetary policy? I asked Mr. McKinnon this question.  
12 Do you regard it as the smoothing of the ups and downs  
13 of business, or the providing of a favourable climate  
14 for economic efficiency and growth? In other words, do  
15 you think the emphasis should be on short run cyclical  
16 changes or on the somewhat longer run developments in  
17 the economy.

18 MR. HART: Mr. Gibson, I do feel monetary  
19 policy cannot be expected to look after the short run  
20 changes in the economy. If that were to be so we would  
21 have frequent changes in the bank rate in various  
22 directions, and I submit that that would probably serve  
23 to cause more confusion than it would help in solving  
24 the problems facing the economy as a whole.

25 I therefore look for monetary policy to  
26 exert a broad influence over a longer period of time  
27 so that business as a whole can gear itself to those  
28 influences and make their plans or future requirements,  
29 and so on. But if the bank rate is going to go up and  
30 down frequently, I submit that that would confuse the





1 situation.

2 COMMISSIONER GIBSON: In short, you think  
3 there are important lags in the response of spending  
4 decisions to monetary policy. We were told yesterday  
5 by one of the people in the Canadian Bankers' Association  
6 -- and it was just a guess and not a positive statement  
7 -- that he thought there was a lag of about 6 months between  
8 a significant change in monetary policy and its effect  
9 on spending decisions.

10 MR. HART: I think it is very difficult, Mr.  
11 Gibson, to put down a stated time for monetary policy  
12 to take effect. It depends on what type of monetary  
13 policy is being pursued, you might say. If monetary  
14 policy is endeavouring to exert a gradual influence  
5 on the economy as a whole, then the effect will be very  
6 gradual. But in a time of real crisis I think that the  
7 effect on a bank's lending and the borrowing require-  
8 ments of customers could be pretty drastic.

9 If in addition to the signal of a very  
0 substantial increase in the bank rate, the Governor  
1 of the Bank of Canada were to call together the  
2 chartered banks and inform them of the seriousness of  
3 a situation, the banks could in turn pretty  
4 effectively through their branch system make sure this  
new policy was going to apply almost immediately.

COMMISSIONER GIBSON: This did happen to a  
degree in late 1955, and 1959 again, did it not?

MR. HART: That is right.

COMMISSIONER GIBSON: Particularly in late  
1955. It did take a little while to make it effective,







1 did it not?

2 MR. HART: It did, Mr. Gibson, and I think  
3 there that perhaps the banks were left a little bit in  
4 the dark. We were operating on a bank rate in 1955  
5 which was a floating rate and it was pretty difficult  
6 to determine from week to week whether or not we were  
7 in a trend that was really a significant indicator  
8 that a serious situation was building up.

9 I think that if at that time the banks had  
0 been called together by the Bank of Canada and had had  
1 this situation explained to them fully, we could have  
2 been much more effective, -- I will not say more effective  
3 but we could have reacted more quickly to the situation  
4 at that time.

5 COMMISSIONER GIBSON: Leaving aside the times  
6 when you get a clear problem in a semi-critical situation,  
7 do you consider that bank lending policy does or should  
8 respond fairly sensitively to the changes in the cash  
9 position of the bank, or should it be insulated by  
0 sales of securities?

1 MR. HART: I believe it has to be insulated  
2 to a degree, for after all if we are performing our  
3 function in the community we cannot be expected <sup>to be</sup> in the case  
4 of extreme crisis/going to our clients and suddenly  
5 shutting off the tap. After all, they have made their  
6 plans which may extend over a period of weeks, months  
7 or perhaps more than a year. If we suddenly go and  
8 say, "This has to stop immediately" I think it would  
9 have a very drastic effect on the economy as a whole.

0 COMMISSIONER GIBSON: Yesterday I asked the







1 Canadian Bankers' Association in effect if they thought  
2 selling securities or restraining loans, looking at the  
3 two ways in which banks respond to tighter monetary  
4 policy, I asked them which one they thought was the  
5 more effective or less effective or whether there was  
6 any real difference in the consequences on the  
7 community and on spending decisions. In other words,  
8 if the central bank holds the cash reserves of the banks  
9 steady, this means total bank deposits cannot increase,  
0 they have to stay fixed, but the stability of bank  
1 deposits can come about either through further sales of  
2 securities on the part of the banks to finance further  
3 increases in loans, or from an earlier response in  
4 lending policy.

5 In the first instance, that is an early  
6 response in lending policy, the banks are directly  
7 trying to dissuade people from making spending decisions.  
8 Why not give them more money? In the second instance  
9 they are taking the liquidity out of the economy, that  
0 is in selling securities, and this results in higher  
1 interest rates and a spread of this throughout the  
2 structure. Have you any views on which has the most  
3 effect on spending decisions, or is there anything to  
4 choose between them?

5 MR. HART: I do not think there is a great  
6 deal to choose between them, Mr. Gibson. If bank  
7 deposits are being kept at a certain level and the  
8 banks have an indication that there is a certain tightness  
9 coming into the system as a whole, they do, after all,  
0 have certain commitments to their customers which I feel





1 they must honour. As I said in answer to an earlier  
2 question, these clients have made their plans for their  
3 future requirements or future credit, and we cannot  
4 suddenly turn off the tap, and therefore by the very  
5 nature of the banking business we find ourselves in a  
6 position where we do have to sell securities, and  
7 possibly at a loss, as has been done in the past. But  
8 that, after all, is, as I say, the nature of banking  
9 business. It is the breaks of the game, to put it in  
10 the vernacular.

11 We do have to suffer these losses, but at  
12 the same time as we are selling securities we do realize  
13 that we have to exert a pressure, gradual though it  
14 may be, in our lending policies so that loans will not  
15 expand to any great extent.

16 COMMISSIONER GIBSON: This is if you reach  
17 the view that this pressure on your liquidity is going  
18 to continue for some time?

19 MR. HART: That is correct.

20 COMMISSIONER GIBSON: Otherwise you would  
21 not change your lending policy?

22 MR. HART: That is correct.

23 COMMISSIONER GIBSON: What I am getting at  
24 is that this is an important matter, for if the effect  
25 of selling securities is less significant in checking  
26 spending decisions than the effect of tightening up  
27 on bank lending policies, then the argument for more  
28 liquidity, for liquidity reserves, is a stronger one  
29 than it otherwise would be. If the effect is just the  
30 same, it is hard to know.







1 MR. HART: It is difficult to know, Mr.

2 Gibson, just what force and effect the various steps  
3 which might be taken can have, but I do feel that once  
4 a bank finds itself in a position of having to liquidate  
5 securities there is a very forceful signal there, if  
6 this continues over any protracted period, that they  
7 must tighten up.

8 COMMISSIONER GIBSON: But the very sale of  
9 securities has an effect on the rest of the community,  
10 does it not?

11 MR. HART: That is correct.

12 COMMISSIONER GIBSON: Thank you.

13 THE CHAIRMAN: May I ask a question in this  
14 area? We have already had some information this  
15 morning about lines of credit, a matter which we have  
16 discussed in the last few days. I suppose one of your  
17 problems is that if you receive a signal that you should  
18 try to curtail business, those who have not used up  
19 the lines of credit are apt to try to use them up if  
20 they foresee tightening in the offing. I suppose you  
21 regard these lines of credit as commitments, or to  
22 what extent do you regard them as commitments? To  
23 what extent do you cut those lines of credit?

4 MR. HART: In the bank which I represent  
5 we certainly do regard these lines of credit as  
6 commitments, in effect. Perhaps it is more of a moral  
7 obligation. It is a guide line as to the extent of  
8 credit which any ~~one~~ operator may require for his  
9 seasonal requirements, but having established that line  
10 of credit, as I said a moment ago, we do feel there is





1 a moral obligation on our part to honour it to the best  
2 extent we can.

3 In times of monetary stringency, that could  
4 place the banks in a rather awkward position in as much,  
5 as you have suggested, sir, there might be a rush  
6 towards the banks to utilize those lines of credit to  
7 the full before they were cut off. But there again I  
8 think it is a matter of the close relationship between  
9 a bank and its customer. We would certainly have that  
10 customer in, or go and see him, and explain the situation  
11 to him as fully as we could, and seek his cooperation  
12 in curtailing his borrowing requirements to suit the  
13 situation which happened to be facing the country at  
14 that time.

5 Then again there are loans for seasonal  
6 purposes that must be met, and we would use our best  
7 ability to look after the borrowing requirements of such  
8 a customer, even though monetary stringency were in  
9 force.

0 THE CHAIRMAN: But as to your customers as  
1 a whole you would attempt to persuade them to reduce  
2 their prospective loans as much as possible?

3 MR. HART: That is correct.

4 THE CHAIRMAN: As far as you could?

5 MR. HART: Yes, sir.

6 THE CHAIRMAN: Would there be any advantage  
in extending these lines of credit to have some  
consideration attached to them so that there would be  
a tendency to ask for the smallest possible lines of







1 credit? Is there a tendency for lines of credit to  
2 be greater than may be absolutely necessary from the  
3 point of view of the customer?

4 MR. HART: I think there is that tendency,  
5 Mr. Chairman. Human nature being what it is you would  
6 want to protect yourself or insure yourself against  
7 the future as much as possible, and, in fact, lines are  
8 established beyond what might be the ordinary require-  
9 ments of a particular borrowing customer.

10 If I judge from your question that you are  
11 thinking of something in the nature of a commitment fee  
12 for the establishment of these lines of credit, thereby  
13 reducing the requests upon the banks for the establish-  
14 ment of such lines, that does pose problems because  
15 once you exact such a fee you are really into a  
16 contractual obligation. Therefore, we would not  
17 have the flexibility which we have now in adjusting  
18 lines of credit during times of monetary restraint.  
19 We would feel honour-bound, having entered into a  
20 contract, that we would have to permit borrowings  
21 up to the full limit of the line of credit that we had  
22 a commitment for.

3 THE CHAIRMAN: Yes, but I understood that  
4 you regarded your commitments now as being honorary  
5 obligations, or that you treated them as such, but that  
6 the lines of credit you do extend now are such that  
7 you have some latitude and you can go to a customer  
8 and attempt to persuade him to cut down,







1                                which you may not  
2 feel justified in doing if he paid for the privilege  
3 of the line of credit?

4                    MR. HART: That is right, sir.

5                    THE CHAIRMAN: But you would visualize  
6 that the whole line of credit would be substantially  
7 less if there was a fee attached to it?

8                    MR. HART: Yes, I think that would be  
9 the case, Mr. Chairman. After all, if they are  
10 going to pay a fee for the unused portion of the  
11 line of credit, I think in the interests of efficiency  
12 and economy that they would like to keep that line  
13 as close to the reasonable borrowing requirements  
14 as would be possible.

15                   COMMISSIONER MACKINTOSH: Would this  
16 fee apply to the unused portion of the line of  
17 credit only?

18                   MR. HART: That is right, Dr.  
19 Mackintosh, yes.

20                   COMMISSIONER MACKINTOSH: This, then,  
21 puts a penalty on asking for a larger line than is  
22 necessary, but it reduces the penalty of using  
23 the line?

24                   MR. HART: That is right, Dr. Mackintosh.

25                   COMMISSIONER MACKINTOSH: The fee  
26 comes off the interest.

27                   MR. HART: Yes.

28                   THE CHAIRMAN: I think that is all.

29                   COMMISSIONER LEMAN: Before we leave  
30 this subject of monetary policy, though, Mr. Hart, I





1 would like to ask you a question about the use of  
2 what is called moral suasion by the central bank.

3 I believe the C.B.A. has explained  
4 to us that when the Bank wants something done it  
5 is a good idea to call the bankers together and  
6 have a full discussion on the commitments that the  
7 country faces, et cetera, and everyone would come  
8 to an agreement as to what is the good and proper  
9 thing to do. Is this the way it works, if we  
10 eliminate the special types of crises -- perhaps  
11 such as we more recently encountered -- but just consider  
12 the more normal type of thing where the economy  
13 is getting under pressure, or seems to be getting  
14 to be getting under some kind of pressure, and  
15 wouldn't there be room for disagreement among bankers  
16 and the Bank of Canada as to what should be done  
17 about it? Maybe prices would go up a bit if the  
18 economy is under pressure. How come you can get  
19 so much agreement by the banks about this thing?

20 MR. HART: I think there is room for  
21 disagreement; none of us are infallible in assessing  
22 the economy at any given time. But when the Governor  
23 of the Bank of Canada calls together the general  
24 managers of the banks or the presidents of the banks,  
25 as he does frequently, he is in a position, I think,  
26 to give the bankers present a good deal of background  
27 information -- which the Bank of Canada is able to  
28 acquire -- relating to the economy of the country  
29 as a whole which perhaps we don't have ourselves.

30 Therefore in laying the facts of the case before







1 announcement is made that the chartered banks have  
2 agreed to do such and such a thing. Are there  
3 other instances where such agreements are made and  
4 the chartered banks start to carry out the policies  
5 without any announcement being made?

6 MR. HART: I can't recall any off-  
7 hand, Mr. Brown, at the present time, but it could  
8 conceivably be the case that owing to the situation  
9 in the country it may not be advisable to make a  
10 statement on a particular issue at the time, hoping  
11 that the action which the banks would take under  
12 the leadership of the Bank of Canada might serve  
13 to smooth out this problem, which happened to be  
14 facing the Bank at that particular time. I don't  
15 say that in every case there should be an announcement.

16 I do say, however, that in times where  
17 there is going to be an abrupt change in monetary  
18 policy that the public has every right to be told  
19 by the Bank of Canada initially, I submit, and also  
20 by the chartered banks to a certain degree, exactly  
21 what the situation is.

22 COMMISSIONER MACKINTOSH: This eases  
23 the position of the chartered banks with its customers?

24 MR. HART: Yes, because we have to  
25 interpret this policy, and it is very difficult  
26 to get people to understand why a certain situation  
27 exists when no one initially made any pronouncement.

28 COMMISSIONER BROWN: You can't blame  
29 it on the Bank of Canada if you can't make it public.

30 MR. HART: We don't attempt to lay blame





1 on the doorstep of the Bank of Canada.

2 COMMISSIONER LEMAN: But doesn't all this  
3 make the exercise of monetary policy much less of  
4 an impersonal thing than sometimes people try to  
5 make it out to be, if moral suasion is one of its  
6 essential elements, rather than just the mechanical  
7 effects?

8 MR. HART: Well, I think generally  
9 speaking, Mr. Leman, monetary policy should perhaps  
10 be impersonal, but there will be certain times when  
11 the situation is such that it demands pretty drastic  
12 steps and therefore it becomes a little less  
13 impersonal, shall I say, and that is the time when  
14 the banks are called together and are faced with the  
15 facts of the situation, or should be called together.

16 COMMISSIONER LEMAN: If it works with  
17 the banks, do you think it would have good chances  
18 of working with the near banks and other people,  
19 too?

20 MR. HART: Well, of course, in the  
21 very nature of things now; the near banks are not  
22 brought into the picture initially to the extent  
23 that the chartered banks are, and I am thinking  
24 now about moral suasion. There really is no control  
25 over the near banks to that extent at the present  
26 time and I think, if I recall correctly, the Governor  
27 of the Bank of Canada did say he wasn't too concerned  
28 about the operations of the near banks at this  
29 stage in view of the volume of the business which  
30 they were handling; but if that volume continues to







1       increase as it has, I think there surely must come  
2       a time when some control of sorts must be exercised  
3       over the near banks, or moral suasion, whichever  
4       you wish.

5                       COMMISSIONER LEMAN: Well, in the sort  
6       of conditions I described in first asking my question,  
7       isn't it the reaction of the banks to say, "Well, why  
8       don't you go and persuade these other fellows, too?".

9                       MR. HART: Well, that is a rather  
10      difficult question to answer, Mr. Leman, as to  
11      what powers they might have to persuade them.  
12      I think this has been brought out before; there was  
13      a case some years ago where an attempt was made to  
14      bring together the finance companies and an attempt  
15      to have them curtail their activities in the lending  
16      field but, as I recall, the Governor of the Bank  
17      of Canada said they couldn't reach agreement.

18                      COMMISSIONER LEMAN: Well, persuasion  
19      with power behind it hardly deserves the adjective  
20      "moral"!

21                      MR. HART: That is right.

22                      COMMISSIONER LEMAN: We might pass  
23      on to something else now. I gather that you do  
24      subscribe to the Association's recommendation about  
25      lifting the 6 per cent limit on interest rates?

26                      MR. HART: Yes, definitely.

27                      COMMISSIONER LEMAN: And you also do  
28      subscribe to the request that the banks have the  
29      right to take mortgage security, but in your opening  
30      statement this morning I understood you to say you







1 didn't think that this would lead the banks heavily  
2 into conventional mortgages on housing. Did I  
3 understand you correctly?

4 MR. HART: Yes, you could infer that  
5 from my remarks, Mr. Leman. The point which I would  
6 like to get across here is that the banks, after all, <sup>have as</sup> /  
7 their prime function -- looking after the short-term  
8 requirements of businesses and individuals. We accept  
9 deposits on short-term -- demand deposits usually,  
10 and even including savings' deposits -- which are  
11 subject to chequing, and our prime function in these  
12 years has been to look after the short-term require-  
13 ments of the economy as a whole. To the extent  
14 that we engage in longer term lending -- and in this  
15 I include the mortgage field -- I think that we would  
16 have to be very careful how far we went in that field  
17 to ensure that we would not jeopardize our prime function  
18 of looking after the short-term requirements.

19 COMMISSIONER LEMAN: Well, Mr. Hart,  
20 when we talked with the C.B.A., I think that we looked  
21 at the spectrum of assets that the banking system  
22 has as a whole, and I believe we asked the representatives  
23 of the Association if this spectrum was quite  
24 typical of each bank, and they said that in general  
25 it could be called typical, but that each bank would  
26 not hold exactly the same proportion of each asset,  
27 but it was typical, so may I ask you if you believe  
28 that this extra flexibility, if this were granted  
29 to the banks and in view of your views about what  
30 would happen in the mortgage field and other views





1 we have heard about it, whether you think this would  
2 lead to greater contrast between banks as to their  
3 respective asset management than has been the  
4 case in the past; is that a likely development?

5 MR. HART: I think that is quite likely  
6 because, after all, it is a matter for management to  
7 judge to what extent they are going to lend funds  
8 in any particular field, and the mix could very well  
9 vary between banks.

10 COMMISSIONER LEMAN: And you feel that  
11 the lack of contrast in the past has been mostly  
12 due to these rather restrictive conditions under  
13 which the banking system could operate.

14 MR. HART: Yes, I think that would be  
15 the case, Mr. Leman.

16 COMMISSIONER LEMAN: Well, this leads  
17 me to ask you whether, therefore, it is likely --  
18 but not overnight -- to curtail this development  
19 of more specialized banking institutions in Canada  
20 than has been the trend in the past?

21 MR. HART: By that do you mean, Mr.  
22 Leman, that new banking institutions would be formed?

23 COMMISSIONER LEMAN: Or could  
24 this development of contrast between their  
25 asset management go so far as to practically lead  
26 them to specialization?

27 MR. HART: I see what you mean. I don't  
28 think in the long run that the pattern of operations  
29 of the chartered banks or the individual chartered  
30 banks would be changed too much because if, as I  
have said, we keep prominently before us the fact that







1 we are looking after or should be looking after short-  
2 term requirements of business and individuals, that  
3 is our prime function, and I don't think you can  
4 get too far astray from that without changing your  
5 organization as such.

6 COMMISSIONER LEMAN: Well, suppose  
7 one bank decided that, well, that is not necessarily  
8 its function; it would like to observe the rules  
9 and keep a certain liquidity, but go in for a  
10 terrific mortgage business?

11 MR. HART: That could happen, Mr. Leman.

12 COMMISSIONER LEMAN: That would be  
13 the effect of specialization?

14 MR. HART: Yes.

15 COMMISSIONER LEMAN: You don't regard  
16 this as a likely development?

17 MR. HART: Not if we keep before us  
18 the objective: which I have mentioned, no, which  
19 I think is our prime responsibility in the banking  
20 system in Canada.

21 COMMISSIONER LEMAN: What do you think  
22 are the chances of creating a condition in Canada  
23 that might lead to new entrants in the field of  
24 true banking?

25 MR. HART: Well, we have gone over this  
26 before, to some extent. The very nature and the  
27 cost of setting up a bank with a branch system in  
28 Canada has, I feel, certainly been discouraging to  
29 anyone who might have considered applying for a  
30 charter under the Bank Act. In addition, the profit





1 motive, to which Mr. McKinnon referred this morning,  
2 is most important, and I think that any new banking  
3 enterprise that was thinking of setting up in this  
4 country would take a pretty long look before applying  
5 for a charter with a 6 per cent ceiling on loan rates.

6 COMMISSIONER LEMAN: How do you regard  
7 this, do you regard this as a weakness from the point  
8 of view of the country as a whole, or what is it?

9 MR. HART: A weakness from the standpoint  
10 that there are no more banks or groups applying for  
11 charters?

12 COMMISSIONER LEMAN: No, the fact that  
13 conditions seem to be such as to not make it very  
14 likely that you would get this. Do you regard this  
15 as a fault in our total setup, or do you regard it  
16 as quite a normal thing?

17 MR. HART: I think as the country grows  
18 and has grown in recent years that there is room for  
19 other banking institutions. This will provide some  
20 competition which is all to the good. I would hate  
21 to be dogmatic and say no, no other banking institution  
22 should be permitted to be set up in this country;  
23 I think that would be quite wrong. On the other hand,  
24 I don't think we want to go all out and have a mush-  
25 rooming of banking institutions, which I think would  
26 have a rather serious effect.

27 COMMISSIONER LEMAN: Do you believe that  
28 price considerations -- and by "price considerations"  
29 here I am thinking of rates on deposits, prime  
30 deposits, loan rates, et cetera -- are the only







1 considerations that cause people, especially individuals,  
2 to go to one institution rather than to any other  
3 to get accommodation.

4 MR. HART: Well, if we may deal first  
5 with deposits, Mr. Leman, I do think that the banks  
6 have been losing deposits to other organizations who  
7 are in a position to pay much higher rates of interest  
8 than we can possibly allow on such deposits.

9 As to loans, the rate, of course, must  
10 be a consideration, and I think that when you are  
11 borrowing money you like to feel that you are getting  
12 the best rate obtainable and I think that there is  
13 an inclination to shop around. There is that type  
14 of person who is attracted, I suppose, by pretty  
15 convincing advertising and will go to certain sources  
16 for credit and obtain loans at higher rates of interest  
17 than they might otherwise obtain if they went to  
18 other sources, and in suggesting this removal of  
19 the ceiling of 6 per cent on lending rates, I have  
20 very much in mind the flexibility which would result  
21 from the removal of that ceiling and also would  
22 enable the banks to perhaps take on other types of  
23 loans which they cannot do now; loans of a riskier  
24 type, if you will, and charge perhaps a little higher  
25 rate of interest, which would be considerably below  
26 the rates which some people are charged in borrowing  
27 from other sources.

28 COMMISSIONER LEMAN: Would you comment  
29 on whether their problem has been based solely on  
30 these price considerations, which I mentioned, or if  
it has been partly based on other considerations?







1 MR. HART: Well, I think there must have  
2 been other considerations certainly in the case of  
3 credit unions. That is a situation in which people  
4 with common interests have gathered together. That  
5 is a pretty broad term. I think there was even a  
6 case in Vancouver of a credit union where in order  
7 to become a member of it you had only to live in the  
8 city of Vancouver.

9 COMMISSIONER BROWN: That is quite a  
10 common interest.

11 MR. HART: Yes, there are great advantages  
12 to living in Vancouver, Mr. Brown, but I would suggest  
13 that that is not the type of common interest in  
14 respect of which credit unions were originally set  
15 up, nor is it the type of common interest that is  
16 the basis of the credit union movement. Therefore,  
17 this factor of common interest has done much towards  
18 the growth of the credit unions, quite apart from  
19 the rate of interest that may be paid on deposits  
20 or shares, or charged on loans.

21 COMMISSIONER LEMAN: From that angle,  
22 we can consider them as a new entrant into the banking  
23 business.

24 MR. HART: Very much so.

25 COMMISSIONER LEMAN: And, therefore,  
26 there might be considerations other than that of  
27 just price that might enter into the development of  
28 other institutions in the country in the banking  
29 business?

30 MR. HART: That would be, as I endeavoured





1 to point out, the fact in the case of credit unions.  
2 There is some other motive apart from cost or price.

3 COMMISSIONER MACKINTOSH: I have been  
4 interested, Mr. Hart, in some of the things you  
5 have commented upon already, such as the possibility  
6 or the facility for entering into banking. In fact,  
7 the number of banks in this country has declined  
8 greatly from decade to decade. Assuming permission  
9 were given for the taking of mortgage security is  
10 there any chance that the kind of entrants into the  
11 banking system would be the development in large  
12 cities of what were at first savings and mortgage banks  
13 which would gradually expand into commercial banks?  
14 Would this be a way of cutting down the long  
15 unprofitable period that has been mentioned before  
16 they could build up a branch system?

17 MR. HART: I think it could be, Dr.  
18 Mackintosh. After all, the branch system, as such  
19 as operated by the chartered banks, is being continually  
20 enlarged. We are continually opening branches in new  
21 localities, and those branches do run at a loss for  
22 some period of years, but by virtue of the fact that  
23 we are operating profitably in large centres, and  
24 doing a good business, we are able to cushion ourselves  
25 against these losses more adequately than a new entrant  
26 into the field could. But, perhaps a new entrant  
27 would have to build up a business in a large centre  
28 and sort of skim the cream off the top, so to speak,  
29 and develop a very profitable business, and then  
30 it would be in a position to gradually extend out into







1 other areas where it would operate at a loss for some  
2 time in the expectation that it would turn the whole  
3 operation into a profit-making venture before too  
4 long.

5 COMMISSIONER MACKINTOSH: I do not  
6 want to go over the discussion we had with Mr.  
7 McKinnon, but do you think that the links which  
8 exist particularly between banks and trust companies  
9 in any way limit the independence of these organizations  
10 or these institutions, or affect their market action?

11 MR. HART: It would be my opinion,  
12 Dr. Mackintosh, that they are not limited in the slightest  
13 degree. We have seen the trust companies grow quite  
14 substantially in recent years, and enter into other  
15 fields of lending which, prior to that time, they  
16 had not been particularly aggressive in, and also  
17 in the matter of taking deposits from the public.  
18 While there may be some fairly close relationships  
19 between a bank and a trust company, even beyond the  
20 extent of owning shares of a trust company by a  
21 chartered bank, relationships which have been  
22 built up over the years, the competition between the  
23 bank and the trust company is nevertheless very keen.

24 I can certainly cite an example of that  
5 between the Bank of Montreal and the Royal Trust  
6 Company, with which we have had a close and friendly  
7 relationship extending back many, many years. One  
8 does not own the stock of the other. It is true  
9 that there is an interlocking directorate to some  
10 extent in that a number of our directors are on the





1 Board of Directors of the Royal Trust Company, and  
2 the chairman of that trust company is on the Board  
3 of Directors of the Bank of Montreal, but nevertheless  
4 there is very keen competition between the two  
5 institutions. I do not think the competition has  
6 been inhibited in the slightest degree by virtue  
7 of this long-standing friendly relationship.

8 COMMISSIONER MACKINTOSH: Has any bank  
9 established links with sales finance companies or  
10 loan companies?

11 MR. HART: Not to my knowledge, Dr.  
12 Mackintosh.

13 COMMISSIONER MACKINTOSH: That is,  
14 other than a customer relationship.

15 MR. HART: That is right, other than  
16 a customer relationship. There may be cases of  
17 where in their investment portfolios the banks  
18 own shares, or they own shares through pension funds,  
19 in finance companies, but I know of no linkage under  
20 which there is any control exercised over a finance  
21 company by a chartered bank.

22 COMMISSIONER MACKINTOSH: The British  
23 banks, I understand, are permitted to control other  
24 financial institutions?

25 MR. HART: That is correct, sir. I  
26 think the British Treasury rather encouraged that  
7 because it does give them a greater control over the  
8 financial community through the commercial banks.

9 COMMISSIONER MACKINTOSH: Does a bank  
0 which controls a finance company use its control, so







1 to speak, in the furtherance of monetary policy, or  
2 does it use the subsidiary finance company as an escape  
3 hatch?

4 MR. HART: I think, Dr. Mackintosh,  
5 that moral suasion might come in here. As has been  
6 brought out before the Commission there is a very  
7 situation  
8 close knit/in the British banking fraternity. They  
9 all operate in London. Their head offices are there.  
10 They can be called together by the Governor of the  
11 Bank of England in a matter of minutes. If the  
12 situation arose where there was a general tightening  
13 of money required it would naturally follow that what  
14 the banks themselves do then so would the finance  
15 companies and higher purchase companies that they  
16 control. But, I cannot speak of the banking system  
17 of Great Britain because that is outside my field.

18 COMMISSIONER MACKINTOSH: There would  
19 be some concern if the development was toward more and  
20 more of these linkages other than through the markets.  
21 We have a chartered banking system with very few  
22 units which are very large. They are, of course,  
23 competitive to a degree. Their power is limited  
24 by not only their own competition but the competition  
25 from the near banks which come in on the fringes  
26 and compete in a particular area. I think that with  
27 a spread of control or linkage it is inevitable that  
28 the competition might not be so keen, excepting what  
29 you have to say about trust companies. I know that  
30 there are commercial companies which are able to  
keep up a very vigorous competition between two rival







1 brands which they themselves control. I have  
2 never thought of it as being real competition in the  
3 ultimate sense. I think that is all I have on that  
4 subject, Mr. Chairman.

5 COMMISSIONER BROWN: I would just like  
6 to ask you, Mr. Hart, your opinion on one matter.  
7 At the moment there is a growing country bank operation  
8 which operates in the range between the interest rates  
9 which the chartered banks are able to pay and the  
10 6 per cent ceiling on which they can charge. If  
11 the 6 per cent ceiling were lifted there would be  
12 a considerable readjustment of the lending rates that  
13 the banks charge, and an evening-out resulting in new  
14 rates, presumably. In your opinion what is the  
15 effect going to be on the country bank operation?  
16 Would there be no change at all, and would they  
17 still fit in? Do you think it would encourage  
18 them to operate in this field, or make it more diffi-  
19 cult for them to operate in this field?

20 MR. HART: I cannot envisage it making  
21 it more difficult. I do not think there would be  
22 too much change. After all, this country banking  
23 system is one that can function without the high  
24 overhead charges, you might say, of the banking  
25 system. It is a very impersonal arrangement.

6 COMMISSIONER BROWN: They just need  
7 your umbrella.

8 MR. HART: Yes, they need our umbrella;  
9 that is quite true. But, I do not think there would  
10 be too much change. Apart from the fact that I have





1 expressed before, that we would hope that by removal  
2 of the ceiling on lending rates the banks would have  
3 a greater degree of flexibility in their rate  
4 structure, and their whole spectrum of rates, I do  
5 not think there would be too much change. It is  
6 quite true that we would have a prime rate which  
7 would be lower, I submit, than it is now, and that  
8 commercial borrowers would then be in a position of  
9 obtaining the best rate obtainable, although that is  
10 not to say that the country banks would <sup>not</sup> meet that  
11 competition and meet those rates, which would be  
12 all to the good from the standpoint of the borrower.

13 THE CHAIRMAN: There is one question  
14 I would like to ask here, and it is with respect  
15 to the exchange rate. You take a different view  
16 from that of Mr. McLaughlin and his understanding  
17 of the exchange rate, having regard to his submission.  
18 In that respect have you anything further you wish  
19 to add in the way of views of your own on this?

20 MR. HART: I think I have nothing further  
21 to add, Mr. Chairman, other than what I have already  
22 said in my submission. If I might develop it a bit  
23 I think that we did find ourselves in a situation in  
24 this country which called for rather drastic action,  
25 and as part of that action we evolved the fixing of  
26 the exchange rate as a matter of self discipline.  
27 Having fixed the rate I feel that we shall, to use  
28 the vernacular, have to stick to our guns. It is  
29 all very well to have a floating rate and say: "Let  
30 us see what happens", but that might involve us in







1 postponing self-disciplinary action for a longer period  
2 than we would under a fixed rate. In other words,  
3 we would not be seized with the importance of taking  
4 such drastic action as any situation might require.  
5 It might drift on too long to the extent that we  
6 would have to take even more drastic action to  
7 correct a situation.

8 THE CHAIRMAN: If I recollect it  
9 correctly, Mr. McLaughlin was not advocating that the  
10 rate should immediately be a floating rate under  
11 the present circumstances, but that in the long run  
12 a floating rate is preferable to a fixed rate. That  
13 was his view.

14 MR. HART: Yes, that is my understanding  
15 too, Mr. Chairman.

16 THE CHAIRMAN: Thank you, Mr. Hart.  
17 We are very much obliged to you for your illuminating  
18 discussion.

19 MR. HART: Thank you very much, Mr.  
20 Chairman.

21 THE CHAIRMAN: We will adjourn until  
22 1.45 p.m.

23  
24 --- Luncheon Adjournment.  
25  
26  
27  
28  
29  
30





1 ---Upon resuming at 1:50 p.m.

2  
3  
4 SUBMISSION OF

5 W. EARLE McLAUGHLIN

6 CHAIRMAN AND PRESIDENT

7 THE ROYAL BANK OF CANADA

8  
9 APPEARANCES

10 W. Earle McLaughlin - Chairman and President,  
11 The Royal Bank of Canada.

12 - - - -

13  
14 THE CHAIRMAN: We will now resume. Mr.  
15 McLaughlin, we are looking forward to a discussion of  
16 your submission which we have read. You may wish to  
17 make a preliminary statement or not. That is entirely  
18 a matter for you to decide.

19 MR. McLAUGHLIN: Mr. Chairman, you have had  
20 my very short brief in your hands since June, nothing  
21 has happened in the meantime to make me want to change  
22 my thesis which is a very simple one, namely, that the  
23 greatest efficiency in our financial system and, there-  
24 fore, the most effective monetary policy, is achieved  
25 by substituting whenever possible competition for  
26 regulation in the market for money and credit.

27 With particular respect to the competition  
28 between banks and near-banks I call for this to be on  
29  
30





1 an equal basis. I submit that this can be done in  
2 two ways, either by placing on the near-banks the  
3 handicaps of the banks, or by extending to the banks  
4 the same freedom of action now enjoyed by the near-banks.  
5 I have argued that the best policy is the latter.

6 I have nothing further to add at this point,  
7 and I am prepared to answer your questions either on the  
8 brief or on any general aspect of banking.

9 COMMISSIONER BROWN: Mr. McLaughlin, one of  
10 your main recommendations in this area is in connection  
11 with the cash ratio and the liquidity asset ratio where  
12 you say:

13 "I would recommend therefore that the  
14 Commission consider either no legal cash  
15 other  
16 or liquidity ratios, or a nominal cash  
17 ratio only, which would not unduly penalize  
18 the banks."

19 I wonder if we could talk about the cash ratio to  
20 start with. It seems to me that there might be  
21 difficulties in cash management unless each chartered  
22 bank was prepared to tell the Bank of Canada the ratio  
23 on which it would endeavour to work, and even then,  
24 while I can see no real problem in the day-to-day  
25 swings between banks that are temporary and which may  
26 be reversed over the course of the next week or so,  
27 I wonder if there could develop problems over the  
28 medium or long term if one bank consistently takes the  
29 cash from another bank which is operating on a different  
30 cash ratio basis.

Let us assume that one bank operates on a







1 two per cent ratio, and another bank operates on a 6  
2 or 8 per cent ratio. In the shorter term I can see how  
3 these will be balanced out because they will be dollar  
4 amounts, but once you start getting a persistent trend  
5 how is this going to be compensated? I would just like  
6 to hear your comments on the problems that might arise  
7 in such a case. Or perhaps there are no problems, and  
8 if so you can say so.

9 MR. McLAUGHLIN: First of all, I am delighted  
10 to hear you using the words "cash ratio". I think  
11 "reserve" is a misnomer ---

12 COMMISSIONER BROWN: May I interrupt you to  
13 say that it is not because of a matter of principle.  
14 I am not making a decision.

15 MR. McLAUGHLIN: No, but it is nice to have  
16 you half-way convinced, anyway. I see no problem, Mr.  
17 Brown. If one bank wants to work to 2 per cent and  
18 another bank wants to work to 6 per cent ---

19 COMMISSIONER BROWN: May I interrupt again  
20 and ask you, first of all, if my suggested thesis is  
21 correct, if it was stated that was what they were going  
22 to work to?

23 MR. McLAUGHLIN: That is true. If one worked  
24 to 2 per cent and another worked to 6 per cent, and they  
25 both told the central bank that they will, indeed, work  
26 to those figures, then there is no problem.

27 Let me explain it in this way. If the  
28 central bank increases by open market operations the  
29 cash reserves, as they are called, or the cash ratio --  
30 the cash in the Bank of Canada -- by one dollar then





1 likely, in the first instance, that will end up in one  
2 of the banks. Let us assume it is the bank that works  
3 to 2 per cent, although it makes no difference. That  
4 bank will do something with that money. Let us  
5 assume further that that bank has 20 per cent of the  
6 business of all of the banks in Canada. In the normal  
7 course of doing something with that money that bank  
8 will end up with only 20 cents extra and the rest of  
9 the dollar will be divided up amongst the other banks  
10 in exact proportion to the proportion of business they  
11 do in the country.

12 COMMISSIONER BROWN: That is quite clear.

13 MR. McLAUGHLIN: So, there is no problem,  
14 whether one works to 2 per cent and the other works  
15 to 6 per cent. There is no problem if you fix the  
16 dollar amount. As a matter of fact, I think, to use  
17 a word that gained some popularity earlier in the  
18 hearings, our thinking on these ratios, and the way  
19 they are tied to deposits, is a little archaic because  
20 of the way that they, under the present law, cannot be  
21 used as a reserve except in the one ultimate eventuality,  
22 namely, the winding-up of a bank. They are not a  
23 reserve, and tying them to deposits in the previous  
24 months makes them look like reserves which they are not.

25 Monetary policy would work just as effectively  
26 if you tied them to, as is the case now, four weeks'  
27 deposits, or two weeks' deposits -- although I do  
28 not recommend that; I think it / would be a hardship on the  
29 banks-- or to deposits of a year ago, or to deposits  
30 of 40 years ago, or even if you used a Ouija board and







1 took numbers from it, as long as the numbers were large  
2 enough to cover the clearings of the banks. You could  
3 leave those forever, because the Bank of Canada is  
4 in complete control of the amount of money on deposit  
5 with the chartered banks, with one exception which it  
6 can counteract immediately, and which is so small that  
7 it is of little significance. I am referring, of  
8 course, to the re-deposit by the chartered banks of  
9 currency, but that in relation to the size of the  
10 deposits is insignificant, and, in any event, the  
11 Bank of Canada can take counteracting action unless the  
12 deposit comes in on the last day of the month, but  
13 those amounts are usually quite small.

14 If I may go on with this subject, because it  
15 is an extremely interesting one, I will say that I have  
16 heard it said in the last few days that the banks have  
17 worked over the years down from 8.5 per cent to, say,  
18 8.1 per cent. That is not true. The Bank of Canada  
19 has permitted it. Because of the way it is calculated,  
20 it is not what the banks want it to be but what the  
21 Bank of Canada makes it, and there is nothing that the  
22 system can do to affect it. The Bank of Canada ends  
23 up any particular month with an average in the banking  
24 system of, say, 8.5 per cent. The more nimble and  
25 astute banks can probably run closer to 8.1 per cent,  
26 but this forces the less nimble and less astute banks  
27 to be above 8.5 per cent, but, in any event, the average  
28 is 8.5 per cent. There is nothing the banks can do  
29 about it, and the reason is because of the nature of  
30 the law. The reserve requirement is composed of three





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1 things. There are the statutory (last month's) deposits  
2 -- those are fixed -- of which 8 per cent must be main-  
3 tained, but that 8 per cent is broken down into two  
4 things of which one is the till money, but that is on  
5 the previous four Wednesdays, so that is fixed. So,  
6 when you start off a month you know what the deposits  
7 were and you know what your till money is. You subtract  
8 the till money from the cash requirement, and ,  
9 that is what you have to work to.





1 But if the Bank of Canada takes action by increasing  
2 or decreasing the cash that the chartered banks have,  
3 they will react immediately, but they are reacting  
4 on this month's deposits, and they cannot change last  
5 month's deposits. There is nothing that can be done  
6 by the banking system to change the 8.5 or the 8.1  
7 that the Bank of Canada makes available.

8 It has been said the banks have reduced from  
9 8.5 to 8.1. I think the Bank of Canada has done that,  
10 simply because the banks, with the development of the  
11 money market, have become better managers, and 8.5 is  
12 not necessary.

13 Yesterday, Mr. Brown, you asked could the  
14 banks work down to 6 per cent or 5 per cent or 4 per  
15 cent. The answer, of course, is, yes, if the Bank of  
16 Canada would permit them.

17 On this subject -- and purely as a mental  
18 exercise and certainly with my tongue in my cheek --  
19 I would like to suggest there may be a major flaw  
20 in either the Bank Act or the Bank of Canada Act --  
21 and probably in the latter. I have mentioned that the  
22 amount on deposit with the central bank by the  
23 chartered banks is in the complete control of the  
24 central bank.

25 If you will refer to section 71 of the Bank  
26 Act, that is the section which says that the banks shall  
maintain a reserve equal to 8 per cent; and the commanding  
word in that section is "shall," and, indeed, there is  
a very heavy penalty under section 140 if they do not. --  
I can find nothing in the Bank of Canada Act which.







1           says that the Bank of Canada must put the banks  
2 in that position.

3           I know what I am saying is a mental exercise,  
4 and it is most unlikely to happen, but there is the  
5 legal possibility of the Bank of Canada reducing the cash  
6 which the banks have to, say, 5 per cent, and there is  
7 nothing the chartered banks can do except pay the  
8 penalty, and there does not seem to be any penalty on  
9 the Bank of Canada if they do that.

10           COMMISSIONER BROWN: This is in the month,  
11 you are discussing?

12           MR. McLAUGHLIN: Yes, it is a legal  
13 possibility, but I do not think it is a practical  
14 possibility. You could reduce it to the absurdity that  
15 the Bank of Canada could legally reduce the cash  
16 to zero, and it would not need to worry about the  
17 guarantee that was mentioned the other day!

18           COMMISSIONER BROWN: Has not the market  
19 some flexibility in the day-to-day loans?

20           MR. McLAUGHLIN: Yes, they are flexible.

21           COMMISSIONER BROWN: In the sense they can  
22 by purchase and resale agreements -- I am always  
23 getting them mixed up.

24           MR. McLAUGHLIN: The Bank of Canada in  
25 conjunction with its money market policy--

26           COMMISSIONER BROWN: In this way they can  
27 enable the banks to do that?

28           MR. McLAUGHLIN: That is all part of the  
29 open-market operations, but they can do it without  
30 changing the money supply.





1 COMMISSIONER BROWN: You did not deal with  
2 my other point. You only dealt with more cash coming  
3 into or going out of the system. You talked about the  
4 Bank of Canada producing another dollar in cash.

5 MR. McLAUGHLIN: Yes.

6 COMMISSIONER BROWN: Would you deal with the  
7 other point, and that is shifts between the banks of  
8 their deposits at the Bank of Canada? I can see over  
9 the short-term it is going to be counter-balanced,  
10 and you do not need to worry about it.

11 MR. McLAUGHLIN: If a bank has 20 per cent  
12 of the business of the country and maintains that  
13 amount it will get or lose 20 per cent of any shift.  
14 If through competitive action it could increase its  
15 share to 21 per cent of the business it will get or  
16 lose 21 per cent of any increase or decrease of any  
17 given amount. No matter what it is, it is proportionate.

18 COMMISSIONER BROWN: If at the moment one  
19 bank increases its percentage from 20 to 25 and all the  
20 other banks are operating on 8 per cent, the bank  
21 that gets the increase does something with it?

22 MR. McLAUGHLIN: Yes.

23 COMMISSIONER BROWN: But the total money  
24 supply remains as at present.

25 MR. McLAUGHLIN: Yes. It might quite  
26 readily one day, from a big transaction on the part  
27 of a customer, jump from 20 to 25 per cent.

28 COMMISSIONER BROWN: Say in the course of  
29 several months?

30 MR. McLAUGHLIN: That can only happen if it







1 is getting 25 per cent of the business, and that is  
2 permanent.

3 COMMISSIONER BROWN: If it increases from  
4 20 to 25 per cent under the same cash ratio as everybody  
5 else, this makes no difference in the total?

6 MR. McLAUGHLIN: No.

7 COMMISSIONER BROWN: But, on the other hand,  
8 if a bank operating at 2 per cent increased its  
9 percentage from 20 to 25, and it was operating on a  
10 lower basis than any other bank, this would have a  
11 greater leverage action?

12 MR. McLAUGHLIN: No. It would only get  
13 25 per cent from any increase in the amount you start  
14 out from.

15 COMMISSIONER BROWN: There is not any  
16 increase -- he has 20 per cent of the market and  
17 builds up to 25 per cent, taking it away from other  
18 banks?

19 MR. McLAUGHLIN: I see.

20 COMMISSIONER BROWN: If that bank is operating  
21 on a 2 per cent cash ratio, as against the rest of the  
22 system, say, operating at 6 or 8?

23 MR. McLAUGHLIN: Presumably his deposits have  
24 gone up, if you are measuring it on deposits -- the  
25 deposits have gone up.

26 COMMISSIONER BROWN: Have not the deposits  
27 increased at a faster rate than the deposits that have  
28 declined in the rest of the system?

29 MR. McLAUGHLIN: No, I do not think so.

30 COMMISSIONER BROWN: He is operating on a





1 lower ratio, is not he?

2 MR. McLAUGHLIN: No. If you are talking of  
3 reserves, he uses it as part of his reserves, but I  
4 do not think it affects the multiplying factor.

5 COMMISSIONER BROWN: Why not; if one part of  
6 the system is operating on, say, a 6 per cent ratio --  
7 and let us call it 16 times -- and another one is  
8 operating on a 2 per cent ratio -- which is 50 times --  
9 if one bank gradually acquires deposits which it is  
10 able to retain in the central bank from the other banks?  
11

12 MR. McLAUGHLIN: Momentarily, he might. But  
13 as he increases his deposits he is losing money, and it  
14 goes to the other parts of the banking system, in  
15 proportion to the business they have. He makes loans  
16 which create deposits and he buys securities, and it  
17 disappears among the system, in relation to the  
18 proportion of the business each bank has.

19 COMMISSIONER BROWN: I agree entirely over  
20 the short-term.

21 MR. McLAUGHLIN: In the long run too. The  
22 long run is just a succession of short runs, and  
23 works out the same way in the long run. What is the  
24 deciding factor in the cash a bank gets or loses is  
25 how much of the business of the banking system it has.  
26 A bank that has 20 per cent, if it creates a loan for  
27 a dollar, in due course it is going to lose 80 cents,  
28 just by the nature of the widespread business of  
29 banking.

30 COMMISSIONER BROWN: I do not quite follow







1 that, on the basis of the leverage.

2 MR. McLAUGHLIN: This is what happens to  
3 the money, and the rest of the system is going to get  
4 it. The man who has a loan for one dollar is going to  
5 issue cheques against it, and that is going to be spread  
6 around the system. In due course the bank that has 20  
7 per cent of the business is going to lose 80 cents  
8 through the clearings.

9 COMMISSIONER BROWN: The secretary has given  
10 me some figures of what I tried to do mentally, and he  
11 has used a greater contrast in order to try to bring  
12 this out.

13 If we assume the total central bank cash  
14 in the system is 100 units of something, and one bank  
15 has 10 per cent of this and is operating on a 2 per  
16 cent basis, and he has 500 of these units in total  
17 deposits, the rest of the system, which has 90 of these  
18 units operating on a 5 per cent basis, has 1800 total  
19 deposits. So the total deposits in the system are  
20 2300. If this one bank, under your aggressive leader-  
21 ship, acquires 20 per cent of the business and now has  
22 20 of these units in the central bank deposits, and is  
23 operating on a 2 per cent cash basis, it now has 1000  
24 units on deposit. Its deposits will now total 1000.  
25 The rest of the system has 80 of these units on  
26 deposit at the central bank, operating on the 5  
27 per cent cash ratio, so they now have only 1600 on  
28 deposit, so the total on deposits in the system --  
29 and therefore, the money supply as at present calculated  
30 -- is now 2600 units. So there has been an increase







1 in the money supply in the whole system without any  
2 change in the cash base by the central bank.

3 MR. McLAUGHLIN: I am sorry, but that cannot  
4 happen.

5 COMMISSIONER BROWN: There are still 100  
6 units.

7 MR. McLAUGHLIN: You cannot increase the  
8 money supply without the cash base being increased.

9 COMMISSIONER BROWN: It is now 2600. What  
10 is wrong with our calculation?

11 MR. McLAUGHLIN: I did not follow all your  
12 figures, but when you said there had been an increase  
13 without the cash base being increased, how can the  
14 banking system increase without an increase in the  
15 cash base?

16 COMMISSIONER MACKINTOSH: Could not the  
17 total deposits increase because the average cash ratio  
18 over the system has changed, because a volume of  
19 business has passed from a high cash ratio bank to a  
20 low cash ratio bank? This could be offset by the  
21 central bank, but it does require offsetting.

22 COMMISSIONER BROWN: I will give you these  
23 figures again, off the record.

24  
25 --- Off the record.

6  
7 MR. McLAUGHLIN: In this situation the  
8 Bank of Canada would have done something. If they are  
9 trying to keep the money supply level there would have  
10 to be offsetting action.





1 COMMISSIONER BROWN: So the central bank  
2 would offset because of your more aggressive action?

3 MR. McLAUGHLIN: Yes.

4 COMMISSIONER BROWN: You will agree with  
5 that?

6 MR. McLAUGHLIN: Yes.

7 COMMISSIONER BROWN: Unless they do something  
8 there will be a change?

9 MR. McLAUGHLIN: They can see what happens,  
10 and they get the figures every week, and there is no  
11 problem that way. I was taking this to the extreme  
12 example. If they are all working to the same thing,  
13 there is not any problem.

14 COMMISSIONER BROWN: If they work to the  
15 same thing there is not any problem, but when they  
16 start operating on a different basis, the central bank  
17 has to decide whether your success in aggression is  
18 temporary or more permanent?

19 MR. McLAUGHLIN: Yes.

20 COMMISSIONER MACKINTOSH: In a sense, the  
21 central bank in figuring out what cash is needed, if  
22 they were operating at different ratios, they would  
23 have to say, "the Royal Bank needs so much; the Bank  
24 of Montreal needs so much" -- and so on, and in  
25 aggregate this amounts to an increase in bank cash  
26 of so much.

27 MR. McLAUGHLIN: I agree it would complicate  
28 it, and I was not recommending it, but I was taking an  
29 example to the extreme point, where you did not have  
30 8 per cent and arrived at considerably less.







1 COMMISSIONER BROWN: Over a short-term,  
2 provided they know the basis on which each individual bank  
3 is operating, there are no problems?

4 MR. McLAUGHLIN: Yes.

5 COMMISSIONER BROWN: So you have changes in  
6 the relative size of the banks in the system and you  
7 get these problems?

8 MR. McLAUGHLIN: Yes. Our experience in the  
9 last few years is that we have been working in a  
10 great many short runs.

11 COMMISSIONER BROWN: Would you consider  
12 anything similar in connection with what is  
13 called the liquid asset ratio?

14 MR. McLAUGHLIN: Do you mean the 7 per cent?

15 COMMISSIONER BROWN: Yes, the 7 per cent.

16 Say each bank informed the central bank of the  
17 percentage at which they were prepared to operate?

18 MR. McLAUGHLIN: I do not see the necessity  
19 of 7 per cent at all. It is not legal; it is a  
20 voluntary agreement. As long as we maintain <sup>it</sup> it, is not  
21 a reserve, and our flexibility only comes from what  
22 we have above that; therefore, since we cannot use  
23 it, it seems to serve no other purpose than being a  
24 captive market for treasury bills and, perhaps, a non-  
25 market approach to monetary policy. I know the Bank  
26 of Canada has said that if we have to keep this we  
27 do not sell treasury bills and stop with a jolt.  
28 But I think that we do, because our flexibility is  
29 only what we have above 15 per cent, and in times of  
30 stress we can sell them; and if we are going to maintain





1 the 7 per cent ratio we get just as much of a jolt when  
2 we reach the 15 per cent, <sup>a minimum of</sup> as we would get when we reached  
3 treasury bills for a real honest reserve.

4 COMMISSIONER BROWN: I think, in general  
5 terms, the thesis of the Governor of the central bank  
6 is that he likes to know how thick your cushion is?

7 MR. McLAUGHLIN: Yes, and I would like to  
8 know why he likes to know. He may control our total  
9 of assets, and he seems concerned only with one of those  
10 assets rather than the total, with what we have in  
11 treasury bills; and when times get tight and there is  
12 an increasing demand for loans, and the monetary policy  
13 is such that the supply is going to be kept level, if  
14 we are going to meet it we have to sell something. He  
15 seems very concerned over treasury bills, but does not  
16 seem concerned at all when we sell long-term bonds,  
17 which is the greatest loss. Our total assets cannot  
18 change, and I, quite frankly, do not understand the  
19 bias towards trying to force us -- if we are going to  
20 meet these loans, and we must in some cases -- to take  
21 the greatest loss; because wherever we sell a long-  
22 term bond or treasury bill it ends up as money some  
23 place and it seems to have the same effect in the  
24 general market.

25 COMMISSIONER BROWN: As soon as you are  
26 selling other than the treasury bills, the bite starts  
27 to become harder, and the monetary policy starts to  
28 become more effective in making it more expensive not  
29 only for the banks, because they have to sell bonds  
30 which have gone down in price, but it also becomes





1 more effective among corporations, and so forth, who  
2 are faced with losses themselves, if they try to change  
3 what was their relative liquidity into cash.  
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1 MR. McLAUGHLIN: I realize, Mr. Brown,  
2 I should not answer a question with a question, but  
3 if we are in the position where the total assets  
4 of the banks are not increasing, I do not see how  
5 monetary policy is any more effective if we sell  
6 one asset or another to get rid of it so we can  
7 replace it with loans. If we have the freedom of  
8 interest rates that we are recommending in all  
9 these briefs, then certainly the minute we start  
10 to sell treasury bills market rates are going to  
11 be affected. Why should we not have the privilege?  
12 One of our problems is we never know how long a credit  
13 squeeze is going to last. Why shouldn't those banks  
14 which may be trying to guess that this is a short one  
15 have the privilege of unloading those assets which  
16 they can unload at the least expense? There may  
17 be at the same time some banks which may think  
18 that this is a long tight money period and that they  
19 should unload the long-term bonds while they can  
20 because if they wait longer it will be more expensive.

21 Why not give the banking system that  
22 flexibility? Why force us not to sell treasury bills?  
23 The total assets of the banking system are not in-  
24 creasing.

25 COMMISSIONER BROWN: The total assets  
26 of the banking system are not increasing, but certain  
27 assets are being changed for more liquid assets.

28 MR. McLAUGHLIN: No, on the contrary --

29 COMMISSIONER BROWN: I am sorry. Certain  
30 deposits are being changed from inactive deposits to





1 active deposits.

2 MR. McLAUGHLIN: You mean when we make  
3 loans?

4 COMMISSIONER BROWN: No, when you convert  
5 a security into a loan you are in effect ---

6 MR. McLAUGHLIN: We are selling a  
7 million dollar bond but presumably, Mr. Brown, that  
8 is the time when we are trying to slow down the  
9 economy, or we would not have tight money.

10 COMMISSIONER BROWN: That is right.

11 MR. McLAUGHLIN: The man who buys the  
12 million dollar treasury bill cannot spend his money  
13 on something else.

14 COMMISSIONER BROWN: No.

15 MR. McLAUGHLIN: What difference does  
16 it make to him whether he buys a long-term bond or  
17 a short-term treasury bill? He still cannot spend  
18 his money on something else.

19 COMMISSIONER BROWN: No, but I think  
20 the presumption is that it is going to cost the banks  
21 more.

22 MR. McLAUGHLIN: That is what we wish  
23 to avoid because we are in the business of making  
24 a profit.

25 COMMISSIONER BROWN: And the central  
26 bank is in the position of wishing to persuade you  
27 not to do it because it is more expensive. I think from  
28 the point of view of the accuracy of monetary policy  
29 control, the thesis is made that it simplifies the  
30 central bank's problems if they know the point at







1 which this bite is going to start to take effect. You  
2 feel that this is not necessary?

3 MR. McLAUGHLIN: What you are saying is  
4 that monetary control goes beyond that normally  
5 associated with the money supply, that they are  
6 endeavouring to control the individual assets of  
7 the chartered banks. That I would object to. I  
8 think they have ample scope in controlling the total  
9 assets. I think it is up to management to decide  
10 how they are divided up. That is my thesis.

11 COMMISSIONER BROWN: I am not putting  
12 forward a thesis. I am exploring your thoughts on  
13 this, and I think you have put your points very  
14 explicitly.

15 COMMISSIONER LEMAN: But you do not  
16 object if the central bank has more than one single  
17 view of what it is trying to achieve? It might  
18 be trying to make sure that with the least possible  
19 lag there will be effects on short-term interest  
20 rates, effects on long-term interest rates, and  
21 effects on lending policies of the banks. It does  
22 not have to restrict the effect of its action to  
23 that small sector of causing you to sell treasury  
24 bills and reduce loans, does it?

25 MR. McLAUGHLIN: Well, Mr. Leman, one  
26 of our problems is that we are never quite sure  
27 exactly what degree of change in the economy the  
28 central bank wants, and by when, and we may or may  
29 not be reacting the way they want us to but we cannot  
30 tell.





1 COMMISSIONER BROWN: At the moment, if  
2 you see a change in the cash held by the chartered  
3 banks in the central bank, presumably this helps to  
4 give you some indication of a trend?

5 MR. McLAUGHLIN: Without a signal, Mr.  
6 Brown, you have to wait a little while before you  
7 know there is a trend. If today Bank "A" sees its  
8 cash, as we call it, a little higher than normal  
9 or necessary, it probably will not move.-- it is  
10 not sure whether there has just been a big deposit  
11 made that will <sup>not</sup> be there the next day. But if this  
12 stays two or three days it will immediately buy treasury  
13 bills or make day-to-day loans because it is expensive  
14 to keep it lying idle earning no interest.

15 It still will not know whether this is  
16 a fortuitous swing to it which may go away in a few  
17 days. It will not know whether it has been lucky  
18 or not until perhaps a week has gone by and it has  
19 seen the figures for the banking system. Do not  
20 forget that when we get the weekly statement on a  
21 Friday, that is of the ten days' previous --

22 COMMISSIONER BROWN: That is right.

23 MR. McLAUGHLIN: If this happened on  
24 Monday, Tuesday and Wednesday and we got the figures  
25 on Friday, we would still not know for another week  
26 what has happened to the other banks. Therefore,  
27 we have to wait. The figures we get are ten days  
28 late.

29 COMMISSIONER BROWN: Is it not a matter  
30 of three days in the case of the Bank of Canada state-







1 ments?

2 MR. McLAUGHLIN: That is right.

3 COMMISSIONER BROWN: So you have the  
4 total in three days.

5 MR. McLAUGHLIN: That is right, but you  
6 have to wait to see whether the system is increasing.

7 COMMISSIONER BROWN: Yes.

8 MR. McLAUGHLIN: And once you know  
9 the system is increasing you sit down and wonder  
10 whether this is permanent. In the past we have  
11 looked around, for example, to see whether there  
12 is a new Government of Canada issue coming out the  
13 following week, for customarily the money supply has  
14 been increased so this issue can be handled and taken  
15 away again. Therefore, if a Government of Canada  
16 issue is coming out in the next week or so you  
17 probably do not make any permanent move until you  
18 ascertain whether or not this is taken away from  
19 you by the tenth of the next month. If it is not,  
20 and there is still no signal, then you begin perhaps  
21 to buy little longer items than treasury bills. You  
22 want to use the money to the greatest profit, and if  
23 you have been in a period of loan restriction you  
24 may gradually relax. But it takes a little time  
25 without a signal to make certain, for it is expensive  
26 to make a mistake.

27 COMMISSIONER BROWN: If you are a bank  
28 operating on, say, 6 per cent, and there are other  
29 banks in the system operating on a lower ratio, you  
30 do not really know, or at least you know even less,







1 what has been happening.

2 MR. McLAUGHLIN: No. You know what the  
3 increase in the deposits of the chartered banks is.

4 COMMISSIONER BROWN: But if the 2 per  
5 cent bank has been losing its share of the business  
6 this might just be to off-set the leverage which  
7 they have lost.

8 MR. McLAUGHLIN: I am sorry, but I do  
9 not want to get back into these figures. I am not  
10 too satisfied on that. Let us make it easy for  
11 this discussion and assume it is a 4 per cent or  
12 5 per cent figure.

13 COMMISSIONER LEMAN: Mr. Brown,  
14 do you not run Dutch auctions every day?

15 COMMISSIONER BROWN: That is all I have  
16 on that point, thank you.

17 COMMISSIONER GIBSON: Mr. Chairman,  
18 Mr. Brown has already discussed with Mr. McLaughlin  
19 the main point I wanted to discuss with him. However,  
20 I should like to carry it a little further and get  
21 your views, Mr. McLaughlin, on how monetary policy  
22 bites.

23 You said that when the central bank  
24 holds cash reserves steady, no matter what the banks  
5 do, deposits are going to stay steady. I do not  
6 say those were your exact words but that was the  
7 meaning.

8 MR. McLAUGHLIN: That is right.

9 COMMISSIONER GIBSON: Whether they sell  
10 treasury bills and allow their loans to increase a bit





1 more or whether they sell long-term bonds, provided  
2 their assets do not increase their deposits cannot  
3 increase.

4 There is a variety of interesting  
5 questions that come out of this. If the banks  
6 sell treasury bills initially in order to allow  
7 for an increase in loans, is the effect of that sale  
8 of treasury bills on the economy similar to the effect  
9 of, let us say, the sale of a bond, a reduction in  
10 a loan? Have you any view on the way this thing  
11 affects the rest of the economy? After all, in  
12 these circumstances what the central bank is interested  
13 in is to check increasing expenditure in the economy,  
14 and it is a question of how these various actions  
15 the bank takes affects spending, which is really  
16 decisive in the view that the central bank takes.

17 MR. McLAUGHLIN: It is very difficult,  
18 Mr. Gibson, to give you a specific answer on that.  
19 Personally I see no difference in the economy between  
20 the sale of a million dollar treasury bill and the  
21 sale of a million dollar 15-year bond. Whoever buys  
22 it does not any longer have a million dollars which  
23 he can spend. I think whatever the effect on the  
24 economy is it must be the same either way.

5 COMMISSIONER GIBSON: You do not think  
6 it matters very much where you subtract the \$15 million?

7 MR. McLAUGHLIN: You cannot trace a  
8 dollar through the economy, and as long as you pre-  
9 vent a dollar from being spent I think the central  
10 bank has done its duty.







1                   COMMISSIONER GIBSON: Let us put it in  
2 a little closer comparative form, a contrast between  
3 selling \$15 million of treasury bills and \$15 million  
4 of medium-term bonds. Let us look at the immediate  
5 effect. Let us suppose this is done in a day or  
6 two days. I presume the immediate effect of selling  
7 \$15 million medium-term bonds would be greater on  
8 the open market than selling \$15 million treasury  
9 bills. Is that correct?

10                   MR. McLAUGHLIN: Oh, yes, it undoubtedly  
11 would.

12                   COMMISSIONER GIBSON: That is the  
13 initial effect. Would the longer effect be different?

14                   MR. McLAUGHLIN: I think it would  
15 work out to the same. If we had freedom of flexibility  
16 in interest rates, the minute we were forced to  
17 dispose of some assets under a fixed money supply  
18 to take care of increased loans, rates would start  
19 to move and I think you would get your normal move-  
20 ment, if there is such a thing in rates, all through  
21 from the shorts to the longs.

22                   It might be less disturbing to the  
23 bond market to sell \$15 million in treasury bills,  
24 but you might have to sell bonds anyway some time.  
25 There is going to be that disturbance ultimately if  
26 the squeeze lasts long enough.

27                   COMMISSIONER GIBSON: You might be a  
28 "bills preferably man". We have heard a lot of  
29 discussion about whether the central bank should  
30 operate at the short end or the long end of the market.





1 The argument for operating at the short end, as you  
2 know, is that it will spread through and the market  
3 will do the spreading. The argument in favour of  
4 operating wherever you like in the market is that  
5 you can have a direct impact on interest rates.  
6 However, from your comments I take it you are saying  
7 that operating in the short end you ultimately get  
8 the similar effect as if you operate somewhere else?

9 MR. McLAUGHLIN: I agree.

10 COMMISSIONER BROWN: I was going to ask:  
11 what is the effect on the liquidity of other people?  
12 If you move \$15 million worth of treasury bills on  
13 the market, the bank is then able to carry on its  
14 operations and make the loan. Market prices generally  
15 are not affected very much, so people who are holding,  
16 say, one-year bonds or two-year bonds still consider  
17 themselves liquid. People holding 15-year bonds  
18 still consider themselves relatively liquid. You  
19 sell long-term bonds instead of treasury bonds and  
20 this has a direct effect on the market. Is there  
21 not a change in the liquidity attitude all the  
22 way through the market?

23 MR. McLAUGHLIN: Well, the first step,  
24 as I say, is that somebody has not got \$15 million  
25 to spend.

26 COMMISSIONER BROWN: I am not thinking  
27 of the effect on the people who buy the bonds or  
28 the people who sell the bonds. I am thinking of  
29 somebody else who has a million dollars of bonds  
30 and is considering doing something. If there is no







1 effect on the bond market and nothing has happened  
2 that might cause him to change his views, if the  
3 bond market suddenly goes down doesn't this have an  
4 effect on him although he has not entered into this  
5 other transaction at all?

6 MR. McLAUGHLIN: That is right. He  
7 cannot sell the treasury bills at the same price as  
8 the bonds.

9 COMMISSIONER BROWN: That is what I  
10 wanted to hear.

11 COMMISSIONER GIBSON: How do you see  
12 changes in interest rates as working? Have you got  
13 a theory or an approach that regards interest rate  
14 changes as more significant than changes in the  
15 availability of credit, or about the same? Do you  
16 have a view as to how monetary policy bites, in  
17 other words?

18 MR. McLAUGHLIN: Well, Mr. Gibson,  
19 whatever I say must be a theory because we have never  
20 had an opportunity to put it into practice. I think  
21 that in the past it has been principally the  
22 availability which has had to function. If we have  
23 complete flexibility of interest rates, both interest  
24 rates and availability will be working together.  
25 It is very difficult to tell which is more important.

26 I would think that interest rates are  
27 greatly significant in capital projects. They might  
28 stop new projects, and as far as the banking system  
29 is concerned it might make it possible for us to  
30 get off our books the so-called pre-issue capital







1 projects which we have financed, pending going to the  
2 market.

3 As far as ordinary manufacturing concerns  
4 are involved, the interest rate does not have the  
5 same importance. I say this for two reasons. First  
6 of all, the government pays half of it. Secondly,  
7 if you look at the operating statement of the average  
8 manufacturing concern and see the cost of borrowed  
9 money for working capital purposes as a percentage  
10 of total costs, an increase of 2 per cent or 3 per  
11 cent in interest rate is not going to make much  
12 difference. If it is sufficient to put him in the  
13 red, he probably has not enough margin to be in  
14 business anyway, but it is insignificant in operating  
15 companies such as that.

16 Where it will really bite is in the  
17 capital projects where something has to be financed  
18 at that rate of interest over 15 or 20 years. That  
19 is when it will slow down as far as the interest  
20 rate is concerned.

1 COMMISSIONER GIBSON: So that monetary  
2 policy in this respect would be most effective at  
3 the capital expenditure end?

4 MR. McLAUGHLIN: I would think so.

5 COMMISSIONER GIBSON: Rather than the  
6 inventory end?

7 MR. McLAUGHLIN: I would think so.  
8 That is where the bite is hardest.

9 COMMISSIONER GIBSON: Now, the more  
10 efficient the market the less chance for error between





1 one financing activity and another, and the more  
2 fluid your interest rate structure is the more you  
3 depend on interest rates rather than availability  
4 as instruments of monetary control. I think this  
5 is a correct thesis. Sometimes the availability  
6 situation is such that people cannot move from one  
7 place to another to get their money readily and you  
8 have blocks set up as you go along.







1 We have heard that thesis put to us that a rather  
2 imperfect capital market is rather better from the  
3 standpoint of monetary control than a good one,  
4 and we have heard the other thesis put as well,  
5 that a perfect capital market is one in which, really,  
6 interest rates are the main guide, and with complete  
7 fluidity there is a price on everything; it is  
8 available at some price or other. Would you care  
9 to make any comment on this? Do you think that monetary  
10 policy would cover this as we gradually perfect our  
11 market mechanisms, or do you think it works more  
12 smoothly?

13 MR. McLAUGHLIN: I think it works  
14 more smoothly through the interest rate structure.  
15 Theoretically, it should be perfect; interest rates  
16 should get high enough so that they affect the  
17 credit interest rates and there would be a perfect  
18 balance between demand and supply; but I don't  
19 think that we will ever achieve that Valhalla because  
20 there is a psychological stumbling block I would think,  
21 Mr. Gibson, although with experience and with some  
22 flexibility it may be removed, but there is this  
23 psychological block that at a certain rate interest  
24 rates are "too high" and we might not be able to go  
25 through that to make the market perfect.

COMMISSIONER GIBSON: We should be  
working towards this better market system?

MR. McLAUGHLIN: I thoroughly agree --

COMMISSIONER GIBSON:

I am not expressing an opinion, I am asking your  
opinion!





1 Well, going on  
2 with this same general idea, another thesis we  
3 had  
4 have/put to us is that little changes in interest  
5 rates, moderate, gradual changes don't have too  
6 much effect; what you need is very sharp changes.  
7 Do you have any view on this, that very substantial  
8 changes are likely to be effective, whereas the same  
9 amount of change which is arrived at very gradually  
10 may not be so effective?

11 MR. McLAUGHLIN: It has less psycho-  
12 logical effect, that is true, but if you are working  
13 towards a perfect market I think some changes will  
14 have an effect; there will be some projects not done  
15 because interest rates have gone up one-half of  
16 one per cent.

17 COMMISSIONER GIBSON: I was working  
18 against the previous thesis a little. In the  
19 perfect market you shouldn't have these sudden  
20 changes?

21 MR. McLAUGHLIN: I don't know whether  
22 not  
23 this is a statement I should/answer or a question,  
24 Mr. Gibson!

25 COMMISSIONER GIBSON: In your brief  
26 or presentation you were pretty specific in paragraph  
27 14 that you regard monetary policy as a short-  
28 term instrument, that is, an instrument designed  
29 to deal with business cycles, the ups and downs of  
30 business, and are you concerned about the lags in  
31 making it effective?

32 One of the C.B.A. people said that he







1 thought six months was about the amount of time,  
2 but he didn't include the lag and what is called  
3 the inside lag in the central bank; the time it takes  
4 the central bank to recognize a situation and do  
5 what is necessary. That would have to be added  
6 to the six months. These lags are likely to gradually  
7 reduce the effectiveness of monetary policy. The  
8 danger is that if you act too late the effect may  
9 come when business has turned the other way.

10 MR. McLAUGHLIN: Mr. Gibson, I think  
11 that the lags, to some extent at least, are desirable.  
12 I would hate to think that we had to move so sharply;  
13 that the Bank of Canada made up its mind today that  
14 it wanted a change and wanted it in effect by Tuesday  
15 of next week. . I don't think we can stand these  
16 sharp changes, and I think we should look for lags  
17 and I think that we should be flexible.

18 Perhaps the answer is that if we are  
19 trying to reduce the lag, that the Bank of Canada  
20 should reduce the first lag. One never knows how  
21 long that lag is. I don't say there is a lag, but  
22 there is the difficulty of saying exactly where we  
23 are in the business cycle until we are really into  
24 it, and then move.

25 I presume there is bound to be a lag  
26 there, but once given a signal -- and, of course,  
27 there is the difficulty, too, that often there is  
28 a slight move, as has happened in the past, without  
29 a signal -- and now that we have bank rate as a sig-  
30 nal perhaps we can move a little more rapidly and cut







1 down the length of the lag. However, I still would  
2 like to see a lag and I agree that six months is  
3 the approximate time, because the last lag is the  
4 hardest.

5 After we get the signal and after the  
6 banks move, then we have to convince by word of  
7 mouth or by refusing loans or cutting loans or something,  
8 we have to convince the customers, but the last  
9 lag is the hardest and what does the customer do  
10 after that, and there is no one who can control that.

11 I would guess, and as a pure guess,  
12 and I think as evidence of the six months lag, that  
13 in this last tight money squeeze which we had in  
14 1962 and which reached its height or depth, whichever  
15 way you want to describe it, in mid-summer, that  
16 if there had not been any relaxation and if the  
17 money supply had been kept permanently at the low  
18 point it reached, a lot of merchants would not have  
19 had a very good Christmas; it would have spread through  
20 the economy by Christmas, and that is about six months.

21 COMMISSIONER GIBSON: Well, maybe lags  
22 are not such a bad thing when people are not too sure  
23 about which way things are going. I got the  
24 impression from the Governor of the Central Bank  
25 that there would only be odd occasions when he would  
26 want to give a really strong signal, and one of his  
reasons was that the central bank couldn't always  
be sure the way things were going, and you are not  
going to get strong signals unless people are fairly  
sure, so would I be fair in taking the burden of your





1 remarks to mean that most of the time you were in  
2 favour of a lag and a fairly decent one so that  
3 there would not be many adjustments until we knew  
4 where we were going, but when it is evident that  
5 there is a real problem and the central bank does  
6 give a signal, that it is very desirable to shorten  
7 the lag?

8 MR. McLAUGHLIN: I think it would, and  
9 we could if we had a proper signal and got it fast.

10 COMMISSIONER GIBSON: You had one in  
11 June.

12 MR. McLAUGHLIN: Yes, and we moved fast,  
13 but one of the most difficult things, Mr. Gibson, --  
14 and all this time we talk about restriction; I hope  
15 some time there is the opposite problem of the  
16 relaxation -- one of the most difficult restrictions  
17 to put in is just a little restriction. You can do  
18 things to your loans, you can do things to your  
19 customers if it is sharp, but how do you handle it  
20 just to cut loans down a little bit; it is difficult.

1 COMMISSIONER GIBSON: You are not  
2 asking me, are you!

3 MR. McLAUGHLIN: No, no. I apologize,  
4 Mr. Gibson, I should have prefaced that by saying,  
5 "This is a rhetorical question"!

6 COMMISSIONER GIBSON: Thank you very  
7 much.

8 COMMISSIONER BROWN: That is what we  
9 are trying to find out; how do you avoid these very  
10 sharp changes?







1 MR. McLAUGHLIN: Well, we will have a  
2 better chance if we have flexibility of interest rates.  
3 If we can see something happening with a little movement  
4 of interest rates that will have a bit of an effect.

5 COMMISSIONER BROWN: As soon as people  
6 start to recognize a small movement in interest  
7 rates, they wonder is the move towards a larger  
8 move, and how long do you think it will be before  
9 each move takes place, and isn't this part of the  
10 trouble, that everybody is watching for signals  
11 and the better we all get at recognizing the signals  
12 the faster we move to protect ourselves?

13 MR. McLAUGHLIN: I quite agree, and  
14 that is why I am delighted with the fixed bank rate;  
15 there is now an opportunity for a signal.

16 COMMISSIONER BROWN: My point is that  
17 if the bank rate moved from -- and let us take figures  
18 that do not exist -- 5 per cent to  $5\frac{1}{2}$  per cent ---

19 MR. McLAUGHLIN: Were to move right  
20 away?

21 COMMISSIONER BROWN: ---don't you think  
22 you would have a terrific loan demand right away?

23 MR. McLAUGHLIN: People are peculiar  
24 that way; in a tight money period you have the  
5 psychology that people want loans who don't otherwise  
6 want them.

7 COMMISSIONER BROWN: That is right.

8 MR. McLAUGHLIN: In some cases we try  
9 to avoid it; there may be hoarding of loans.





1           If I may recite a little interesting history,  
2 and this is between the bank and its customer, and even  
3 though it is trying to look after him, it is like a game  
4 of chess. Now, go back to the 1951 crisis -- not  
5 crisis, the 1951 tight money period. The first one --  
6 we were helped with our customers by a statement from  
7 the Governor of the Bank of Canada, and while there  
8 were many explanations, generally that credit squeeze  
9 was handled by freezing lines of credit, which made  
10 our customers unhappy.

11           Now, in due course, things were eased up  
12 and we forgot about tight money for a while and the  
13 customer thought that he would outsmart the bank, so  
14 in this easy time he asked for substantially increased  
15 line of credit. Now, they were perfectly justified  
16 on the balance sheet basis, and most of them got it,  
17 and they thought they had beaten the system.

18           Then, the next credit crisis came along and  
19 we were not helped by a statement by the Governor, and  
20 in many cases it is difficult to explain to un-  
21 sophisticated people what is happening in the economy,  
22 and we had to outmanoeuvre the customer and in general  
23 -- but with many exceptions -- freeze loans at the  
24 maximum. So, in due course we had money again and the  
25 customer thought that he would outmanoeuvre us, and  
26 at this time of very easy money he would run his loans  
27 up to a great peak for two or three days or a week,  
28 because the last time it was frozen at the peak rather  
29 than the line of credit. Then, the next credit squeeze  
30 came along and we used the average for the year!







1 COMMISSIONER BROWN: What will you use next  
2 time?

3 MR. McLAUGHLIN: I think you have a point  
4 there, Mr. Brown, because in this last squeeze I feel  
5 the customer had no move left and we had no defence, and  
6 both of us have become more mature, and then we went to the  
7 larger borrowers and said, "You see what is happening  
8 to the money supply; we are in a jam, would you please  
9 help us out and take as little as you can or go to the  
10 street", and we got wonderful cooperation.

11 COMMISSIONER LEMAN: People may be perverse,  
12 but they are the only people we've got!

13 MR. McLAUGHLIN: Mr. Leman, may I suggest  
14 that you have a wonderful opportunity when you publish  
15 your report to recommend an alternative

16 COMMISSIONER GIBSON: Mr. McLaughlin, we have  
17 been talking quite a bit about what you do or what the  
18 central bank does when it really wants to tighten things  
19 up.

20 What about to ease things up? What part do  
21 you think that moral suasion has in this process,  
22 assuming a fixed bank rate?

23 MR. McLAUGHLIN: You mean moral suasion  
24 from the Bank of Canada to the banks?

25 COMMISSIONER GIBSON: Right.

26 MR. McLAUGHLIN: Mr. Gibson, I don't like  
27 it. The only advantage moral suasion has is that it  
28 gives the banks at least an opportunity to attempt moral  
29 dissuasion.

30 COMMISSIONER GIBSON: Perhaps we should leave







1 "moral" out of this?

2 MR. McLAUGHLIN: I think it runs contrary  
3 to my general thesis of free competition and free  
4 markets.

5 We have had in the past, I think, two major  
6 attempts at moral suasion on the part of the Governor  
7 of the Bank of Canada. One was the 7 per cent secondary  
8 reserve, and as much as I objected to it, the banks  
9 agreed then because it was like the iron fist in the  
10 velvet glove, and the alternative was to increase the cash  
11 ratio from 8 to 12 per cent, and one didn't have to  
12 sharpen one's pencil very much to find out that 7  
13 per cent earning interest was probably better than  
14 another 4 per cent not earning interest.

15 The second attempt at moral suasion was in 1956  
16 or 1957 when we were in a period of tight money, which  
17 commenced sharply in November of 1955, and the banks  
18 which had been competitive in the National Housing  
19 Act mortgage business withdrew for obvious reasons.  
20 The banks were persuaded in one of these years --  
21 and I have forgotten exactly which year -- by the  
22 Bank of Canada to undertake to make additional new  
23 mortgage loans under the National Housing Act of, I  
24 believe, \$150 million, although it may have been  
25 \$100 million, under a promise that we could count on  
26 an increase in the money supply sufficient to permit  
27 us to handle it.

28 With the benefit of hindsight, it would  
29 appear that the money supply probably was going to be  
30 increased that much, and this moral suasion resulted





1 in a direction as to which particular asset the  
2 banks were to put on their books. When an increase  
3 in the money supply is fixed by a change in policy  
4 I would much prefer that it be out in the open, and that  
5 the law be changed after full discussion, and I would  
6 say that moral suasion should be used only in an  
7 emergency where there is not time to do things properly.

8 That is not to say that there should not be,  
9 as there is now, full, free and frank discussion between  
10 the Governor and The Canadian Bankers' Association and  
11 the Presidents. We like to know as much as possible  
12 about the thinking of the central bank and they like  
13 to know about the chartered banks' thinking. Now, we  
14 can discuss our ideas in a free and friendly atmosphere,  
15 which we do, but I don't go with moral suasion.

16 COMMISSIONER GIBSON: The two examples you  
17 gave of moral suasion are both examples where the  
18 banks were invited to move in a particular way. Now,  
19 there was also another example, a loan ceiling; the  
20 idea of putting a ceiling on loans, and I think that  
the banks agreed to that in November of 1955. They  
were to try and do it in a few months. What do you  
think of that as an emergency technique?

MR. McLAUGHLIN: Are you referring to  
1955 or 1951? In 1951 there was this agreement that  
we were ---

COMMISSIONER GIBSON: I guess it is 1951.

MR. McLAUGHLIN: We were to keep loans at  
the target date, which was February, 1951. I had  
forgotten, but that was another attempt at moral suasion.







1 That was our first experience, after the war years, in  
2 monetary policy.

3 Well, I still maintain that the Bank of  
4 Canada should do it through open market operations,  
5 because otherwise we don't have the freedom which I  
6 think management should have to decide how to divide  
7 up our assets.





1 COMMISSIONER GIBSON: In other words, you  
2 are going to get an effect on the cash or a bank rate  
3 signal, or both?

4 MR. McLAUGHLIN: Exactly.

5 COMMISSIONER MACKINTOSH: Would this argue,  
6 Mr. McLaughlin, for certain standby powers on the part  
7 of the Bank of Canada to deal with these extraordinary  
8 situations as a sort of moral suasion?

9 MR. McLAUGHLIN: I would hate to think that  
10 there were standby powers hanging over our heads. I  
11 think the banks have reacted in the past to crises very  
12 well, and if we are satisfied that what the Governor  
13 is asking us to do will solve the crisis then of course  
14 we will cooperate. But, it is a fearful thing to have  
15 to operate a bank knowing that there are two or three  
16 sections of the Bank of Canada Act that can come down  
17 on you at any time.

18 COMMISSIONER MACKINTOSH: But the Bank of  
19 Canada would have to have your cooperation in order to  
20 vary the cash ratio.

21 MR. McLAUGHLIN: On my thesis it does not  
22 have to do that. It can do it through open-market  
23 operations with the cash.

4 COMMISSIONER MACKINTOSH: Are you not rather  
5 arguing that moral suasion is enough?

6 MR. McLAUGHLIN: Is enough?

COMMISSIONER MACKINTOSH: Yes.

MR. McLAUGHLIN: Do you mean our moral  
suasion to the Governor, or his to us?

COMMISSIONER MACKINTOSH: Well, both.





1 MR. McLAUGHLIN: I do not know, Dr. Mackintosh.

2 In a crisis I think it would, but with respect to normal  
3 operations the Bank of Canada has the facilities, and I  
4 would like to see it use them completely.

5 THE CHAIRMAN: You mentioned conferences with  
6 the Governor from time to time, and you apparently  
7 consider that sort of activity as being useful, providing  
8 it is<sup>not</sup>/for the purpose of moral suasion. How far would  
9 you expect the Governor to go in a conference at that  
10 time in disclosing his views as to the economic trends,  
11 as he sees them? Would you expect, if he were to make  
12 a change, that he should discuss it with you before he  
13 made it, whether it be in one direction or another?  
14 What sort of discussion do you contemplate?

15 MR. McLAUGHLIN: I could say this, Mr.  
16 Chairman, with all due respect to the Governor --  
17 and I am sure I would do the same thing if I were  
18 Governor -- he never goes as far as we would like.  
19 That is not a criticism, because I do not think he  
20 can. But, these meetings are valuable from the point  
21 of view of the Governor's getting the feeling of the  
22 bankers. He will obtain information as to the demand  
23 for loans, and what it is likely to be, and in some  
24 cases he does give us an indication of what he thinks  
25 is going to happen in the economy. However, I would  
26 not like those meetings to give us a signal, because  
27 I think the signal should be made public. I think it  
28 is unfair that only the bankers should know it. The  
29 country should know it as well.

30 I would like those meetings to supplement







1 and elaborate a public signal, but I do not think we  
2 should expect a signal in those meetings.

3 THE CHAIRMAN: By a public signal do you  
4 mean a signal that might require to be interpreted,  
5 or a statement from the Governor of a definite nature?

6 MR. McLAUGHLIN: Well, ideally, a proper  
7 signal such as I would like would be a change in the  
8 bank rate accompanied by a statement. It may be that  
9 there is a case for just a statement without a change  
10 in the bank rate -- one of these little, little moves,  
11 perhaps, -- but I think the public should know as well  
12 as the banks. For one thing, of course, it makes our  
13 job a little easier, but I am not asking it for that  
14 reason. If the customer knows what is happening you  
15 can accomplish what you are setting out to do with a  
16 little less difficulty.

17 THE CHAIRMAN: We will recess for five  
18 minutes at this time.

19  
20 --- A short recess.

21  
22 COMMISSIONER LEMAN: When the recess  
23 intervened, Mr. McLaughlin, I was going to refer to  
24 the fact that there is a slight difference in wording  
25 between your submission of last July and the speech  
26 that you delivered to your shareholders on January  
27 10 of this year on this matter of the cash ratio  
28 requirement. In your speech you did not imply it  
29 was not necessary to have a standard ratio. You said,  
30 rather, that the ratio might be reviewed with the dual





1 objective of reducing it to a lower level -- that does  
2 not imply not having one, and not having a standard one  
3 -- and having interest paid on the part that is held  
4 in the form of deposits by the Bank of Canada. Do you  
5 have any firm views as to what that lower level might  
6 properly be?

7 MR. McLAUGHLIN: Basically, Mr. Leman,  
8 I was giving you lots of opportunity to choose. What  
9 a lower level would be -- I would say this will vary  
10 between banks depending upon their experience and  
11 efficiency, but, including the till money which we must  
12 keep, it would probably be 5 per cent. I am speaking  
13 for my own bank. It might properly be around 2 per  
14 cent or a fraction over for till money, and 3 per cent  
15 or a fraction under, perhaps, for clearing purposes.

16 COMMISSIONER LEMAN: Now, is it your  
17 impression -- I think you have explained to us before  
18 that the banks were enabled by the Bank of Canada to  
19 work smoothly fairly close to the 8 per cent level, and  
20 that the banks also through the actions of the Bank of  
21 Canada could work as smoothly close to the 5 per cent  
22 level.

23 MR. McLAUGHLIN: There would be no problem  
24 at all.

25 COMMISSIONER LEMAN: They could perform just  
26 as well at that lower level?

27 MR. McLAUGHLIN: Exactly. They could work  
28 as well at 5 per cent, or  $5\frac{1}{2}$  per cent or 6 per cent,  
29 or at any figure that was sufficient to provide room  
30 to manoeuvre in the clearings, and that is all.







1 COMMISSIONER MACKINTOSH: Recollections are  
2 hazy and I think the definitions were different, but  
3 was it not originally 5 per cent?

4 MR. McLAUGHLIN: Dr. Mackintosh, it is a  
5 coincidence perhaps -- it was 5 per cent on a daily  
6 basis, rather than on an average for the  
7 month, and there was a severe penalty, the nature  
8 of which I have forgotten now because it is ancient  
9 history, if you went below. So on the average, since  
10 you could not go below, the banks carried approximately  
11 10 per cent, which seems to confirm the 5 per cent  
12 figure I am talking about.

13 COMMISSIONER MACKINTOSH: Does it follow  
14 that if they were given the 5 per cent again they would  
15 operate at 10 per cent?

16 MR. McLAUGHLIN: Not on an average, oh, no;  
17 that is too expensive.

18 COMMISSIONER LEMAN: There is another point  
19 on which I would like to have your view, Mr. McLaughlin.  
20 You refer, in your submission to the fact that you  
21 do not see any particular advantage to near-banks being  
22 included in the group which has clearing accounts  
23 with the Bank of Canada. You say you do not see any  
24 advantage in it, but do you see any disadvantages, or  
25 objections, to it?

26 MR. McLAUGHLIN: May I say why there is no  
27 advantage first? The principal reason why the  
28 chartered banks have accounts with the Bank of Canada  
29 is for open-market operations. The reason why it is  
30 not necessary, in my view, for the





1 near-banks to have accounts with the Bank of Canada,  
2 as they do not have them at the present time -- I think  
3 you will find that in my brief I have qualified it by  
4 "at the present time" -- is that they do not have the  
5 type of client who is affected by open-market operations,  
6 and therefore, there is no advantage in having them.  
7 Do you mean disadvantages for clearing purposes?

8 COMMISSIONER LEMAN: Perhaps for clearing  
9 purposes.

10 MR. McLAUGHLIN: There are just so many of  
11 them that I think it would be very cumbersome, and it  
12 would be of no use at the moment in open-market  
13 operations. Twenty, thirty, or forty years from now,  
14 if the ~~open~~ near-banks then have the same type of  
15 customer as do the chartered banks, and, the clients  
16 of the near-banks are affected by open-market operations,  
17 it might be necessary then, but it is not at the moment.

18 COMMISSIONER LEMAN: I was thinking of  
19 another concept which is an idea that maybe these  
20 institutions do not have to become complete banks all  
21 of a sudden, but that there might be a gradual process  
22 under which they would come into certain relationships  
23 with the Bank of Canada, and then gradually as they  
24 approach the true and complete banking operations --  
25 if that is their future -- they would gradually have  
26 to fall in with all of the different ---

27 MR. McLAUGHLIN: I can visualize the time  
28 approaching gradually, but I think it is still a long  
29 way off, when that might be necessary. It might have  
30 to depend upon the size of the near-bank, and whether







1 or not it permitted the issuance of orders against its  
2 accounts.

3 COMMISSIONER LEMAN: We have asked other  
4 would  
5 people what/happen if the banks were enabled to take  
6 mortgages as security for loans, and we have had quite  
7 a variety of views on this. One was that the banks  
8 might invest fairly large sums in conventional mortgages,  
9 and might continue on in the NHA mortgage market, if  
10 the interest rate ceiling were lifted. Another view  
11 that was not, perhaps, so general, was that the banks,  
12 or some of them, might use that power in order to give  
13 more accommodation to some type of customer that they  
14 have been cultivating up to date. What do you believe  
15 would happen?

16 MR. McLAUGHLIN: Three things, I believe,  
17 or perhaps, a combination of three things. I am not  
18 asking in my brief for permission to take mortgages  
19 for the sake of taking mortgages. I am asking for the  
20 removal of the restriction along with the removal of  
21 all the restrictions so that the competitive base as  
22 between the banks and the near-banks is equalled.

23 Assuming the restriction on mortgages was  
24 removed it would facilitate the banks, I believe, in  
25 making certain loans and taking mortgage security for  
26 them, but I am referring here to a type of loan which  
27 I would not call a mortgage loan. Perhaps I can give  
28 you an example. The banks are frequently asked to  
29 finance the construction of buildings, an apartment  
30 or a factory, pending the completion and the placing  
on completion of a pre-arranged mortgage from an







1 insurance company or a mortgage company. In such  
2 instances, we might be a little happier if during the  
3 year or year and a half that it takes to construct the  
4 building we could have a mortgage on it. If that were  
5 possible I think it is probable that we<sup>would</sup>/do that, but I  
6 would not call it a mortgage loan. It is just extra  
7 security for something we are doing in any event.

8 COMMISSIONER MacKEEN: Do you not usually  
9 get, Mr. McLaughlin, a letter of intent from the  
10 ultimate holder of the mortgage that he will finance  
11 the building on completion?

12 MR. McLAUGHLIN: The normal security in that  
13 case is an assignment of the monies that will be  
14 available on completion under the prearranged mortgage  
15 agreement, but no bank objects to having a little extra  
16 protection if it can get it. In such an event we would  
17 have a mortgage in the interim which would be discharged  
18 upon the introduction of the permanent mortgage. That  
19 is not a mortgage loan as such.

20 The second thing is that it could well be  
21 that the banking system might make a few mortgage loans  
22 or, maybe, a few term loans with mortgage security,  
23 on a plant, but not very many. In other words, it  
24 would be marginal business or fringe business --  
25 perhaps fringe business is a better description. The  
26 banks would not be doing much of this, but many of the  
27 near-banks are doing it and they would then be doing  
28 it as an equal, and would be steadily representing  
29 the major part of it, and their business would be  
30 impregnable and unattacked.





1           The third thing that might happen is that  
2           there could well be a difference in policy between the  
3           chartered banks. It might well happen that one or more  
4           banks may decide that they should go slowly but steadily  
5           into the mortgage business.

6           In my own view, I would not want to do that  
7           because I look upon the chartered banks as having a  
8           major and more profitable business -- because we are  
9           out to maximize our profit; that is our function --  
10          in the provision of short-term working capital and  
11          personal loans -- loans with a short-term bias.

12          I still believe that in our economy we are  
13          going to have from time to time tight money or less  
14          easy money. It is going to have its ups and downs.  
15          I think that a sound bank should not operate on a  
16          system where it is in and out, and I think it is a  
17          policy mistake for a bank to go into mortgages and  
18          term loans when it is flush, and immediately withdraw  
19          when it is not. So that a bank that decides to make  
20          a practice of going into term loans or mortgage loans  
21          will probably try to stay in it so that it will not  
22          then have to retract from this other type of business.  
23          It could well develop over the years that bank A becomes  
24          known as a mortgage bank, bank B as principally a  
25          personal loan bank, bank C as a term loan bank, and  
26          bank D as a working capital bank.

27          I do not know which will happen as between  
28          the second possibility, which was that of just  
29          furnishing competition, and the third possibility  
30          that I mentioned. It could be either of those, or







1 some combination.

2 COMMISSIONER MacKEEN: If Bank A was able  
3 to oblige its customers by granting a mortgage would  
4 not Banks B and C be forced to follow?

5 MR. McLAUGHLIN: Competition is a strong  
6 factor, Mr. MacKeen, but a bank with a long view might  
7 say: "We are losing business now because we are not  
8 making mortgage loans, but when the tight money cycle  
9 comes along those making the mortgage loans will not  
10 be able to satisfy their clients, and in providing  
11 working capital loans we will take the business away  
12 from them then". That may be the hope, and that may be  
13 what you might ultimately get. There may be a gradual  
14 spread between one bank in the mortgage business and  
15 another bank. But, competition is a peculiar thing,  
16 and it may be that all may do a little bit of everything.  
17 One possibility is my second point, that of competition  
18 of the fringes, and doing a little bit.

19 COMMISSIONER MacKEEN: There would be a  
20 danger in a tight money period if you had a highly  
21 developed mortgage department which you wanted to  
22 continue even during the tight money period, if you  
23 made a loan to a customer on a mortgage and refused  
24 another customer who wanted it for commercial reasons.  
25 There would be a certain amount of ill feeling.

26 MR. McLAUGHLIN: There would be, indeed,  
27 and that is where the bank that did not make mortgage  
28 loans might be able to create some goodwill by saying,  
29 "That man should come to us. We are not tied up in  
30 mortgage loans. We have room in which to give you your  
working capital".





1                   COMMISSIONER MacKEEN: The mortgage  
2 field is reasonably well satisfied at the present  
3 time, the same as they are in the general banking  
4 business, but if there is active competition on  
5 the part of the bank it might have a rather serious  
6 effect on the people who depend on that type of  
7 business as their bread-and-butter business. Then  
8 when a period of tight money came they might not  
9 be able to make loans as they do nowadays, even  
10 with tight money. They might be so reduced in  
11 circumstances they could not carry on their business  
12 during tight money periods. Is not that a danger?

13                   MR. McLAUGHLIN: It is a danger for  
14 the mortgage lending companies to have competitors  
15 who are in in good times and out in hard times. It  
16 would be hard on the mortgage lending companies.

17                   COMMISSIONER MacKEEN: That is all  
18 I have to say.

19                   COMMISSIONER LEMAN: If these  
20 restrictions or limitations on the banks were to  
21 be removed, Mr. McLaughlin, would you say that quite  
22 a lot of the handicaps under which the near-banks  
23 operate should also be removed? There are more  
24 than sometimes appears from what we find in the  
25 bankers' submissions. Under some provincial laws  
26 they suffer handicaps too. They do not have quite  
27 the same lender of last-resort access. They have  
28 equity-to-liability ratios to work under. Would  
29 you say that for competition reasons they should  
30 be provided with the utmost freedom consistent with







1 the safety of the people who deposit money with them?

2 MR. McLAUGHLIN: I will quarrel with  
3 only one statement you made, and that is the dis-  
4 advantages the near-banks suffer when compared to  
5 with regard to lender-of-last-resort access,  
6 the chartered banks/ because the chartered banks  
7 can borrow only for seven days and the near banks  
8 can borrow for more than seven days; but apart from  
9 that I fully agree.

10 My thesis is to equalize competition.  
11 I ask that the restrictions on the chartered banks  
12 should be taken off. I also will agree to the  
13 restriction on near-banks being taken off so that  
14 if they are playing the same game, the rules are  
15 the same for both of us, and it is fair and equal  
16 competition.

17 COMMISSIONER MACKINTOSH: Assuming  
18 these restrictions were taken off. Would both  
19 the removal of the interest ceiling and the removal  
20 of the prohibition against mortgage lending enable  
21 you to go further in making loans to smaller businesses,  
22 small industrial firms, and so on?

23 MR. McLAUGHLIN: It would enable us.  
24 Whether we would or not is another question. There  
25 is this strong bias towards short-term lending  
26 because, after all, the chartered banks borrow  
27 short. I think you would find an increasing  
28 tendency to look just a little longer  
29 at a more satisfactory interest rate and with more  
30 satisfactory security than you can get now. There  
will be a tendency towards that, I think, Dr. Mackintosh.







1 COMMISSIONER MACKINTOSH: Let me be  
2 a little more specific. In the case of small  
3 industrial firms, have they not frequently a lack  
4 of security for loans?

5 MR. McLAUGHLIN: Yes, indeed. Many  
6 of them, if they are in rented premises, if they  
7 are manufacturers. Of course Section 88 is available  
8 and the bank can finance the inventory and receivables;  
9 but their machinery is beyond the bank, normally.

10 COMMISSIONER MACKINTOSH: What about  
11 if they are not in rented premises, you cannot take  
12 mortgage securities there?

13 MR. McLAUGHLIN: We cannot on the plant.  
14 If they need it, they have to get it elsewhere.

15 COMMISSIONER MACKINTOSH: I am thinking  
16 of a substantial part of the securities which the  
17 Industrial Development Bank takes, which is in the form  
18 of mortgages.

19 MR. McLAUGHLIN: Yes, I think, mostly.

20 COMMISSIONER MACKINTOSH: Would permission  
21 for you to take mortgages increase your activities  
22 in that field?

23 MR. McLAUGHLIN: I think there are  
24 better ways of doing it. If you will pardon the  
25 expression, RoyNat is a much better way, because  
26 it has larger leverage. There is a capital of  
27 \$10 million in RoyNat now, and basically there is  
28 no difference between the four corporate partners,  
29 \$10 million in RoyNat and \$10 million in term  
30 loans. RoyNat will be able to borrow





1 from the public long, and the leverage will be quite  
2 fantastic. I think that is the way to do that,  
3 because you tie up that much less, but are able to  
4 facilitate that much more long-term loans.

5 COMMISSIONER MACKINTOSH: I have another  
6 question in another field. I forget the number of  
7 the section, but there is a section of the Bank  
8 Act which prohibits banks from going into any other  
9 trade or engaging in any other trade or business,  
10 or controlling firms in it.

11 MR. McLAUGHLIN: Yes.

12 COMMISSIONER MACKINTOSH: What is the  
13 effective purpose of this? Is it desirable?

14 MR. McLAUGHLIN: I suppose it is  
15 historic, but it is to keep us as banks, whatever  
16 "banks" are.

17 COMMISSIONER MACKINTOSH: Is the use  
18 of the term "control" not a very effective one?  
19 Banks could be substantially engaged in a lot of  
20 things, indirectly, without having control, in  
21 the arithmetical sense of holding 51 per cent of  
22 the stock.

23 MR. McLAUGHLIN: That is quite  
24 true, with the exception that some banks have  
25 an interest in trust companies, but I do not think  
26 that section is ever used except for holdings on  
27 real estate subsidiaries.

28 COMMISSIONER MACKINTOSH: If you are  
29 developing this highly competitive set of institutions,  
30 is there some reason for concern that they should all







1 deal with each other at arms' length and without  
2 interlocking directors, stock holdings, traditional  
3 arrangements, and all the other links that there  
4 are between banks and trust companies?

5 MR. McLAUGHLIN: I think nature will  
6 take care of that. The bank I represent deals  
7 with a great many trust companies, but there is  
8 one it has a very close relationship with, although  
9 absolutely no stock ownership. It is a matter of  
10 reciprocity; that is why the relationship, because  
11 the banks cannot do trust business, and until fairly  
12 recently trust companies did not do banking business --  
13 but that has changed somewhat.

14 COMMISSIONER MACKINTOSH: Each  
15 generates business for the other?

16 MR. McLAUGHLIN: Yes, that is right.  
17 There is no control, I can assure you on that.  
18 The trust company I refer to has an office in  
19 the building our head office occupies, competing  
20 with us for the savings accounts. If I had any  
21 control over it I would much sooner have it in  
22 the building the Bank of Montreal occupies than  
23 that which the Royal Bank occupies, but I cannot  
24 control that.

25 If, in the course of time, and given  
26 the freedom we recommend, trust companies and banks  
27 begin to appear to be more similar, then, I think  
28 if there is any conflict in the course of time  
29 there will be gradually a division amongst the  
30 directors, if that is necessary. Directors retire,





1 directors die, and if it is necessary, and if there  
2 is a conflict, as they are gradually replaced they  
3 will be completely separate. I do not see the  
4 necessity now, but it may come.

5 COMMISSIONER MACKINTOSH: Thank you.

6 THE CHAIRMAN: Is there anything you  
7 would like to say about the foreign exchange rate?

8 --- The witness looked whistfully at his watch!

9 THE CHAIRMAN: I mean, a concise  
10 statement.

11 MR. McLAUGHLIN: Thank you, Mr. Chairman.  
12 I was about to ask if you had any schedule for  
13 getting your report in!

14 I do not know what I can say, except  
15 that I have always been a firm believer in the  
16 efficacy of the floating exchange rate  
17 for Canada, in Canada's peculiar position; and I  
18 have not changed my mind.

19 Mention has been made in the last  
20 few days of the disciplines forced upon us by a  
21 fixed exchange rate. There are disciplines; but  
22 under a fixed exchange rate there are two sides  
23 to the coin. If the dollar is over-valued you  
24 have to have disciplines; but if it is under-  
25 valued you have a forced lack of discipline; and  
26 I think the automatic discipline of the floating  
27 exchange rate is better.

28 One other thesis I have is that we must  
29 not look at the exchange crisis in the mid-summer  
30 of 1962 as the fault of the floating exchange rate,







1 because we had not been on the floating exchange rate  
2 since late in 1960. The floating exchange rate  
3 is blamed for many things. It is like taking a  
4 thermometer out of the mouth of a man with pneumonia  
5 and sticking it under the cold water tap, and saying  
6 that he is better. You do not correct things by  
7 moving the exchange rate. There are other things  
8 you need to correct.

9 I could go on for hours on this, but  
10 I do not know whether I would convince anybody. I  
11 still believe that as soon as we can -- with ample  
12 exchange reserves to give confidence to the public  
13 when we do it -- we should abandon the pegged rate  
14 and go on to the floating rate, because if we have  
15 another crisis on the pegged rate -- and I see no  
16 reason why there should be one, and I want to make  
17 that perfectly clear, and this is hypothetical --  
18 but if we do have another crisis, surely, I do  
19 not know how we could handle it, because we cannot  
20 handle it the same way as last time. Last time  
21 there was desperately tight money and it was solved  
22 by contracting the money supply drastically, which  
23 forced the banks, at a capital loss, to dump Government  
24 of Canada bonds at such a capital loss that non-  
25 residents could rush in and buy them at those  
26 attractive yields and have a capital gain. The  
27 banking system suffered, and if we have another crisis,  
28 surely the banking system is far too extended now to  
29 dump that many bonds again, and I do not know how  
30 we could solve it. I emphasize: I see no crisis







1 coming, but let us get off the fixed rate before one  
2 does -- whether it is ten years away or at some other  
3 time -- because if you are on a floating rate you cannot  
4 have a crisis. We have helped to worsen -- and I do not  
5 know whether it matters in Canada or not -- the balance  
6 of payments problem of the United States, because of the  
7 inflow of capital under the pegged rate. Under a float-  
8 ing rate it would not have happened since there can be  
9 no inflow or outflow of gold or U.S. dollar reserves  
10 unless the Canadian Exchange Fund is a net buyer or  
11 seller of foreign exchange, and it can be neither under  
12 a true floating exchange rate. U.S. dollar exchange  
13 operations on private account by the chartered banks  
14 do not affect official exchange reserves in either  
15 country and the U.S. dollars stay within the commercial  
16 banking system of the United States.

17 One of the reasons why the United States  
18 did not have a balance of payments problem from 1951 on,  
19 when there was this heavy inflow of capital from the  
20 United States, was our floating exchange rate. This is  
21 not the only thing that is causing worry in the United  
22 States, but they seemed very happy when we went on the  
23 pegged rate, but they are very disturbed concerning  
24 their balance of payments and outflow of gold, and we  
25 helped partially in contributing to that problem. I do  
26 not say we should make any move merely to help the United  
27 States; we should do it in our own self-interest.

28 The pegged rate is not the right rate  
29 for very long, but the floating rate is. The floating  
30 rate was blamed for being too high. It was a free-  
market rate and was not artificially pegged until  
late 1960. It hindered the exporters, I





1 agree, and it was about to come down, I think, because  
2 the United States were doing things and there was  
3 not the opportunity for capital in Canada. One  
4 of the reasons it was so high was that we had  
5 followed for so long a tight-money policy and  
6 interest rates were high in Canada. On the one  
7 hand we were complaining about the inflow of capital  
8 and on the other hand <sup>were</sup> we encouraging it by high  
9 interest rates. That was not the fault of the  
10 exchange rate. We got off tight money and went  
11 to easier money and interest rates were falling.  
12 That, coupled with the normal dimension of inflow  
13 of capital, because we were in slacker times and  
14 there was not the opportunity to invest capital,  
15 would have brought the Canadian dollar to the dis-  
16 count the exporters wanted. We forced it down  
17 and it got away from us, and we had a crisis. Too  
18 many people look at the thermometer and not the  
19 disease.

20 I do not think I have anything further  
21 to add, Mr. Chairman.

22 THE CHAIRMAN: Thank you very much,  
23 Mr. McLaughlin, for this very interesting dis-  
24 cussion.

25 There are with us in this room today  
26 three other bank presidents: Mr. Lambert of the  
27 Toronto-Dominion Bank, Mr. Moquette of the Mercantile  
28 Bank, and Mr. Boyer of the Provincial Bank. I  
29 understand that none of these gentlemen has expressed  
30 any desire to make a submission to this Commission,







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*Toronto, Ontario*

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1 but it may be that some of you gentlemen may wish  
2 to make some comments arising out of the discussion.  
3 If so, we would be very glad to hear from you.

4 Mr. Lambert, have you anything to  
5 say, or is there anything you wish to add?  
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1 MR. LAMBERT: Mr. Chairman, I am grateful for  
2 the invitation which was extended to me to submit a  
3 brief. It certainly was not through any lack of interest  
4 on my part that I did not do so, but I did feel that the  
5 submission of the Association covered the area very  
6 broadly and I did not have any particular points I  
7 desired to add to it.

8 I followed the discussions of the last three  
9 days with very considerable interest and I do not think  
10 there are any special points I would care to make, but  
11 if there are any questions the members of the Commission  
12 wish to put to me I shall be very happy to endeavour  
13 to answer them.

14 THE CHAIRMAN: I do not know if there are any  
15 other questions that anybody can contrive.

16 COMMISSIONER MACKINTOSH: Other than to ask  
17 which of the other three presidents you agree with.

18 MR. LAMBERT: Perhaps I would say I do not  
19 find any of them the perfect man. We have taken a  
20 different view on the exchange rate and I cannot claim  
21 to have always held the view it should be pegged. It  
22 certainly did not concern me the first few years in my  
23 life, but since 1956 we have advocated the fixing of it.  
24 We think we have an obligation to the other trading  
25 countries in the western world as a member of the Fund,  
26 and we regard it as imposing upon Canada a very desirable  
27 discipline.

28 We also feel that the floating rate was given  
29 an extended opportunity to show what it could do, and  
30 throughout most of that period I think it is generally





1 regarded that it continued our dollar on an over-valued  
2 basis.

3 Currency is usually expected to represent the  
4 cost within a country and I think a country of the  
5 geographical size of Canada with small markets has of  
6 necessity a rather higher cost basis than larger coun-  
7 tries, and a premium dollar did not seem to reflect  
8 this.

9 We had something over ten years of trial with  
10 it and throughout that period, certainly within the  
11 last five years of it, I do not think it served Canada's  
12 best interests.

13 COMMISSIONER LEMAN: Mr. Lambert, now that  
14 you are before us and have offered to answer questions,  
15 may I put this to you? You have listened to the questions  
16 we have asked the other presidents as well as a good deal  
17 of the questions we asked members of the Association.  
18 How do you view the results, the possible results, of  
19 granting banks the right to take mortgage securities  
20 for loans?

21 MR. LAMBERT: I believe that it covers a certain  
22 amount of important savings in the country, and that  
23 some portion of our assets could be properly directed  
24 to term lending and that mortgage lending is probably  
25 the most appropriate of the term lending field. I  
26 would not think that the banks would be inclined to  
27 put a disproportionate share of their deposits into  
28 mortgages, but we have through experience under the  
29 National Housing Act -- and this will be on an  
30 increasing basis -- found that there is a very substantial







1 turnover of money coming in from payments. As the years  
2 go on, with increases in the amortized system in which  
3 payment schedules are arranged, I would think that there  
4 are resources within the banking system which could be  
5 appropriately directed into the mortgage lending field.

6 COMMISSIONER LEMAN: Do you think it would  
7 be possible or practical, avoiding any constitutional  
8 problems or anything like that, to give other lenders  
9 access to other types of security that only the banks  
10 now have under the special sections 82, 86 and 88?

11 MR. LAMBERT: I would have no objection to  
12 it. It would not be my view that it would have much  
13 practical effect. I do not think other lenders would  
14 be very much tempted into that area. They are rather  
15 more dedicated to one-time assets of a situation and  
16 meet an investment on that basis rather than as banking  
17 which is a continual moving of assets from month to  
18 month. I would not think that it would have much  
19 practical effect on other lenders. But certainly I  
20 would not object to them having the power.

21 THE CHAIRMAN: Thank you very much, Mr.  
22 Lambert.

23 MR. LAMBERT: Thank you, sir.

24 THE CHAIRMAN: Have you anything to add, Mr.  
25 Boyer?

26 MR. BOYER: Mr. Chairman, I thank you for  
27 inviting me to speak but I do not think I could add  
28 anything to help the Commission today. I have not  
29 prepared any notes for that purpose.

0 THE CHAIRMAN: Thank you, Mr. Boyer. We shall





1 now adjourn until 9:15 Monday morning next when we  
2 shall hear a submission from the Inspector General  
3 of Banks, Mr. C.F. Elderkin..  
4

5 --- Adjournment.  
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# Royal Commission on Banking and Finance

PRESIDENT - BANK OF MONTREAL  
PRESIDENT - THE ROYAL BANK OF CANADA  
PRESIDENT - CANADIAN IMPERIAL BANK OF COMMERCE

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SUBMISSION

TO

ROYAL COMMISSION ON BANKING AND FINANCE

BY

G. ARNOLD HART

PRESIDENT, BANK OF MONTREAL

January 1963





SUBMISSION

TO

ROYAL COMMISSION ON BANKING AND FINANCE

BY

G. ARNOLD HART  
PRESIDENT, BANK OF MONTREAL

1. I welcome the privilege of appearing before this Royal Commission and of saying a few words which may, I hope, be in some way or another germane to its deliberations.

2. The thoughtful presentation of The Canadian Bankers' Association has necessarily been voluminous, and no useful purpose would be served by an attempt on my part to re-summarize its contents. My own remarks will, therefore, be confined to only a few points which I regard as rather fundamental to an assessment of the role of the banking function in the economy.

3. A few comments regarding the relationship of the Bank of Canada to the chartered banks may be an appropriate starting point.

4. In my opinion the central bank already has at its disposal an entirely adequate "armoury" of legislatively determined "weapons" whereby it may regulate the aggregate cash reserves of the chartered banking system and thereby regulate the level of bank deposits. Moreover, and for reasons which need not be elaborated, there is no lack of opportunity for frequent contacts of a less formal nature between the central bank and the chartered banks.







1        5.        A legally required cash reserve ratio is,  
2        of course, the fulcrum whereby the central bank can  
3        directly influence the chartered banking system by  
4        making cash scarce or plentiful in relation to the  
5        requirements of the reserve ratio as such. In my  
6        opinion, the present legally established minimum  
7        average ratio of 8%, and the statutory method by  
8        which the minimum cash requirements are determined for  
9        the purposes of this ratio, constitute a good,  
10       time-tested workable procedure. The 8% level itself  
11       does not tie up in cash, and therefore render  
12       useless for other purposes, a larger amount than  
13       the requirements of prudent banking would, in any  
14       event, dictate. The averaging technique is realistic  
15       in that it recognizes that quite large amounts of  
16       cash come and go each month between individual  
17       banks in the system and averaging therefore cushions  
18       adjustments which could otherwise be unnecessarily  
19       disturbing in their impact.

20       6.        I am well aware that the Bank of Canada  
21       is empowered to raise the legal reserve ratio, by  
22       successive steps, to a maximum of 12%. I think the  
23       Bank of Canada has been wise in not exercising that  
24       power and relying instead on open market operations  
25       to regulate cash in relation to the 8% minimum  
26       requirement rather than raising the requirement  
27       itself. I would hope this situation continues.  
28       The money market is deep and broad enough to permit  
29       an adequate volume of open market operations and,  
30       in my view, any change in the reserve requirement





1 could only be justified in the event of some great  
2 emergency.

3 7. The secondary reserve in the form of day-  
4 to-day loans and Government of Canada treasury  
5 bills is not statutorially determined but exists on  
6 the basis of a "gentlemen's agreement" between the  
7 banks and the Bank of Canada. The legally required  
8 8% cash reserve plus the "informal" 7% secondary  
9 reserve together constitute the minimum 15%  
10 liquidity ratio under which the banking system  
11 operates. It will be quite apparent, therefore,  
12 that the "free" or usable liquidity available to  
13 any bank is not the 15% which is tied up partly  
14 by law and partly by informal agreement, but the  
15 excess over that figure. In my opinion, no useful  
16 purpose could be served, and some harm might be  
17 done, by endeavouring to crystallize the 7%  
18 secondary reserve in the form of a legal requirement.  
19 To speak very frankly on this point, I have grave  
20 doubts of the wisdom of a statutory secondary  
21 reserve requirement which would make the banking  
22 system a legally "captive market" for Government  
23 of Canada short-term obligations. The provision has  
24 never been misused in this way but I can see no  
25 good reason for establishing a legal basis for  
26 potential misuse. Further, I question the wisdom  
27 of incorporating in legal form, a provision which  
28 it might well prove desirable to modify, possibly  
29 at short notice, by agreement between the banks and  
30 the Bank of Canada, under some set of circumstances







1 not now foreseen. In short, this is, to my mind,  
2 an area in which discussion and mutual agreement  
3 between the banks and the Bank of Canada which has  
4 operated excellently up to the present, might well  
5 be continued in that fashion.

6 8. Turning to matters beyond the area of  
7 techniques as such, I would suggest that such  
8 problems in respect of the relationship of the Bank  
9 of Canada to the chartered banks as have arisen in  
10 the past have stemmed not from a lack of means of  
11 influence, formal or otherwise, but rather from a  
12 lack of understanding as to the direction in which,  
13 and the purposes for which, influences were being  
14 exerted.

15 9. It is for this reason that I welcomed the  
16 return in June last, to a more conventional  
17 rediscount rate technique. The dual rate which  
18 has been introduced, i.e., a fixed "Bank Rate"  
19 applicable to advances obtained by the banks from  
20 the Bank of Canada, and the lower of the floating  
21 rate, as previously determined, or Bank Rate  
22 applicable to accommodation extended by the central  
23 bank to money market dealers is a workable  
24 procedure which has a great deal to commend it.

25 10. But leaving techniques aside, the basic  
26 principle which has been re-affirmed and re-established  
27 is that the central bank does have a responsibility  
28 to signal from time to time, to the banking system,  
29 and to the money market, its views that a change  
30 in the direction of monetary policy is desirable.





11.           Regarding frequency of changes in Bank Rate,  
I should think that a middle ground will be desirable  
between very frequent alterations on the one hand,  
and on the other, changes so infrequent that they  
reflect developments of only very major and critical  
importance. The danger in the latter case might be  
that changes, when they were made, would tend to be  
too large and too late and thus conducive to  
instability rather than to the processes of smooth  
adjustment.

12.           What I have said to this point perhaps  
suggests a somewhat broader consideration. I think  
it could be argued pretty compellingly that here in  
Canada, especially in the post-war years, there has  
evolved a kind of "folklore" with respect to interest  
rates and monetary policy. The central theme of  
this folklore is that "easy money" with its attendant  
low interest rates is "a good thing" and that any  
departure from easy money is "a bad thing" for which  
somebody, somewhere, somehow, should be blamed.  
I deplore this "cops and robbers" approach in  
popular assessment of monetary policy.

13.           I certainly do not need to inform this  
Commission that different situations require  
different monetary policies and that an "easy money  
policy" may be beneficial in some circumstances and  
positively harmful in others. But I do think that  
there is still room for a good deal of public  
education in respect of this fact, which while  
readily apparent to those closely concerned with





1 money policy, does not so readily leap to the eye of  
2 the layman.

3 14. For example, I doubt if, in the past,  
4 sufficient stress has been placed on the fact that  
5 in boom times adherence to an easy money program,  
6 superficially popular though that program may be,  
7 can have thoroughly undesirable costs in terms of an  
8 inflationary spiral at home and an impairment of our  
9 competitive position in world markets.

10 15. Or to take another example, arising out of  
11 very recent experience, maintenance of a fixed  
12 exchange rate clearly implies that, at times, monetary  
13 policy must give external considerations priority over  
14 purely domestic objectives. Indeed, in this respect  
15 I would go further and suggest that even with a  
16 floating exchange rate it is not possible to operate  
17 monetary policy with a bland disregard of the position  
18 of the balance of international payments. If the  
19 balance of payments is heavily adverse, and if at  
20 the same time we are for one reason or another  
21 experiencing capital outflow, corrective measures  
22 will have to be undertaken. In such circumstances  
23 absence of responsibility to maintain an exchange rate  
24 may only mean that the necessary unpalatable  
25 adjustments of domestic monetary policy may be delayed,  
26 and that when they do take place, may be all the  
27 greater for having been deferred.

28 16. There is, of course, room for argument  
29 about the timing and duration of any particular phase  
30 of monetary policy. But under conditions wherein a







1 trend towards higher interest rates and attendant  
2 monetary restraint is clearly in the national interest,  
3 there is, I think, a responsibility on the part of all  
4 those who make official monetary policy to tell the  
5 Canadian public, frankly and fearlessly, why such a  
6 policy is desirable.

7 17. So much for some admittedly broad but,  
8 I hope, not entirely irrelevant references to  
9 monetary policy as such. I turn now to a few  
10 observations regarding the Canadian chartered banks.

11 18. May I make a point at the outset that  
12 perhaps does not need to be made at all and that is  
13 that the interests of the chartered banks are those  
14 of the Canadian community at large. High levels of  
15 business activity and employment are in the interests  
16 of the Canadian economy; that kind of a business  
17 background is very much in the interests of the banks.  
18 Any well-run business organization is anxious to  
19 preserve and extend its share of the market and to  
20 behave itself as a good citizen in ways which will  
21 command public approval. The banks have these same  
22 objectives. Few, if any, Canadian business enterprises  
23 can determine the business environment in which they  
24 operate. The banks cannot determine theirs. They  
25 can do little, if anything, to create a demand for loans  
26 when for one reason or another the demand is sluggish.  
27 Furthermore, the ability of the banking system, as  
28 a whole, to bring about any significant expansion  
29 in its assets and liabilities is at all times, and  
30 properly so, subject to the regulation of the central





1 bank.

2 19. It is no secret that in recent years  
3 one of the fundamental problems facing the banks  
4 has been the matter of adjustment to the concurrent  
5 development of an increasingly broad and increasingly  
6 sophisticated money market. Along with this we have  
7 seen the rapid expansion of quasi-banking functions  
8 performed by other financial institutions now  
9 referred to in popular parlance as "near banks".  
10 As a result of this it is now possible, under  
11 presently existing circumstances, for holders of  
12 large liquid balances to employ funds in the money  
13 market, or in "near banks" at higher rates of  
14 interest than the banks can pay. Conversely, it is  
15 possible for short-term borrowers of significant  
16 amounts to use the facilities of the money market  
17 at lower rates of interest than the banks can  
18 afford to charge.

19 20. To some extent this situation is the  
20 result of forces which may prove to be transitory.  
21 Business conditions in Canada have for several years  
22 been less active than we wish. New capital expansion  
23 by industry has latterly been at a relatively low  
24 ebb. One of the consequences of this has been a  
25 high degree of corporate liquidity. A good many  
26 corporations have therefore had funds available for  
27 employment in the money market; but under more  
28 buoyant business conditions such funds would be  
29 employed by business concerns for the purposes of  
30 their own expansion programs rather than being lent







1 to someone else. I mention this only to suggest  
2 that under more active business conditions the  
3 money market may not prove to have the receptivity  
4 and depth which it has displayed in the past year  
5 or two.

6 21. In any event, a point which I think  
7 needs making is that the function of banking is  
8 basically different from surrounding money market  
9 activities. The money market is a completely  
10 impersonal mechanism. It provides no guarantee of  
11 continuity of accommodation or no tradition of  
12 long familiarity with a borrower's situation or  
13 problems. The borrowing customer of a bank expects,  
14 and rightly so, something more than money at a  
15 rate. He expects a continuity of service, an  
16 intimate knowledge of the nature and problems of  
17 his business on the part of his banker and he  
18 expects his bank to be there when "the going is  
19 rough ". Indeed, ironically enough, most of the  
20 borrowing that goes on in the "street market"  
21 can only take place by reason of the fact that  
22 the borrower has a line of credit with his bank  
23 sufficient to cover not only bank loans he may have  
24 outstanding at the time but also the amount of his  
25 commercial paper borrowings. In a very real sense,  
26 therefore, the chartered banks stand as banks of  
27 rediscount for the commercial paper market.  
28 Incidentally, this might indeed create a problem  
29 for the banks and for monetary policy generally if,  
30 under conditions of monetary stringency, any





1 substantial amount of the unknown figure of total  
2 credit extended in the commercial paper market were  
3 suddenly to return to the banks.

4 22. May I make another and closely related  
5 point. Borrowing customers of banks, together with  
6 users of the commercial paper market who depend on  
7 their banks as lenders of last resort, also depend  
8 on the banks for the continuity of banking services,  
9 surrounding and ancillary to lending operations,  
10 which services the commercial paper market cannot  
11 possibly provide. In other words, I suggest that  
12 "bank money" is different from "market money";  
13 "bank money" is accommodation plus reasonable  
14 continuity, plus services; "market money" is just  
15 money. Indeed, much the same can be said on the  
16 deposit side. The depositor who "works his money"  
17 through the various market media now open to him,  
18 gets an interest rate and nothing else, but the  
19 banking services upon which he relies still have  
20 to be performed by the banks.

21 23. I do not make these observations in  
22 any spirit of complaint. The money market is a  
23 fact of life; it is performing a function; and  
24 the banks will have to live with it. Similarly,  
25 competition from the "near banks" for deposit  
26 funds and also in the lending field is equally  
27 a fact and one to which the banks will have to  
28 adjust.

29 24. Indeed, I might go further and suggest  
30 that the relationship of the "near banks" to the





1 monetary system as a whole raises some pretty  
2 fundamental questions from the standpoint of monetary  
3 control in that influences exerted by the central  
4 bank impinge directly upon the chartered banks and  
5 much less directly, if at all, on the activities of  
6 the quasi-banking institutions. The implications  
7 of this have been explored in great detail in the  
8 Brief submitted by The Canadian Bankers' Association  
9 and I have nothing to add to the very important  
10 points which have been brought forward in these  
11 respects.

12 25. Regarding the chartered banking system,  
13 however, I would emphasize that in my view a  
14 desirable and workable "sorting out" of banking and  
15 quasi-banking functions cannot take place unless the  
16 chartered banking system has a greater degree of  
17 flexibility than is now available to it within the  
18 present legislative framework of its operations.

19 26. I suggest that one of the primary barriers  
20 to a more flexible banking system is the legal  
21 ceiling of a 6% rate on bank loans. The Brief  
22 submitted by The Canadian Bankers' Association has  
23 dealt with this matter cogently and at length. I  
24 would like to add my own view that, while the  
25 concept of a ceiling may have had some validity when  
26 the banks were to all intents and purposes the sole  
27 source of short-term credit, it is no validity today  
28 when banking ought to be conducted under conditions  
29 of much greater rate flexibility and must indeed  
30 be so conducted if the banks are properly to fulfil







1 their function.

2 27. I should like to make it clear with all  
3 the force at my command that I am not advocating  
4 the abandonment of the rate ceiling with the thought  
5 that "if only the ceiling were removed the banks  
6 could make a lot more money." The banks do have  
7 a sense of responsibility in this regard and even if that  
8 were not the case, competitive forces would be a most  
9 effective barrier to any misuse of rate flexibility.  
10 In my opinion, abandonment of the ceiling would  
11 accomplish four major and desirable objectives:

12 First, it would permit the banks to assume  
13 a reasonable proportion of credit risks,  
14 some of them of longer than conventional  
15 term, which cannot be now undertaken at the  
16 ceiling rate.

17 Second, flexibility in the respect just  
18 mentioned would, I think, also be a potent  
19 force in reducing the level of rates in  
20 respect of a wide area of lending now  
21 going on outside the banks.

22 Third, greater flexibility on the side of  
23 rates charged would also permit greater  
24 flexibility in respect of rates paid by  
25 way of interest on deposits.

26 Fourth, the flexibility so achieved would  
27 be a two-way matter permitting more rapid  
28 response to underlying monetary conditions,  
29 by way of reductions in lending rates  
30 as well as in increases.





28. The question of rate is, however, only a part of this matter of increased flexibility. It is a curious anomaly of existing banking legislation that, whereas a bank may acquire, by way of an investment, a mortgage obligation of a corporation, it cannot take mortgage security in the ordinary course of its lending business. Similarly, the conditions under which a bank may acquire chattel mortgage security are now so limited as to render this important form of security unavailable to the banks in respect of commercial lending.

29. In brief, and without going into greater detail, I would hope that the next revision of the Bank Act will reflect a thorough house-cleaning of limitations on the banks' lending powers with a view to broadening the area of usefulness of the banking system in the present day economy.

30. My own recommendation would be that, among other changes that should be made, the banks should be permitted to take mortgage security as a matter of course, such permission to include the power to acquire first mortgages on residential property outside the aegis of the National Housing Act.

31. I should perhaps make it clear that in recommending broader and more streamlined lending powers for the banks, I do not visualize that the nature of banking assets would be fundamentally altered thereby. At a time of intense competition







1 there is always the temptation to believe that  
2 all would be well if one could only do the business  
3 that other people are doing. Specifically, I have no  
4 sympathy with the view sometimes put forward that  
5 "the way for the banks to compete with the trust  
6 companies is to get into the trust company business."  
7 Nor do I visualize if the banks are empowered, as  
8 in my opinion they should be, to acquire residential  
9 mortgages outside the confines of the National  
10 Housing Act, that the banks would or could supplant,  
11 to any major extent, other institutions for which  
12 such mortgage lending is a primary concern.

13 32. It is, in my view, a false assumption  
14 that the banking system will always, and under  
15 all conditions, have sufficient resources at its  
16 disposal to do, in a big way, every kind of  
17 lending business that might conceivably be thought  
18 of as an addition to the banks' present powers.  
19 For one thing, the kind of over-all credit expansion  
20 that this might involve could be far beyond the  
21 limits which a properly conducted national monetary  
22 policy would indicate. In my opinion, the banks  
23 should have the widest possible area of flexibility  
24 in respect of their lending powers in order to  
25 look after special situations. But I would  
26 envisage that the banks would always have to observe  
27 some degree of priority in the manner in which  
28 their resources were deployed. In summary, it  
29 is my belief that the primary lending function  
30 of banking is to look after the short-term





1 borrowing requirements of businesses and individuals.

2 33. Beyond that area there are peripheral  
3 lending functions which I believe the banks could  
4 usefully perform to the extent that national  
5 monetary policy is prepared to see the assets  
6 and liabilities of the banking system expand, and  
7 also to the extent that the resulting change in  
8 the nature of bank assets would be consistent with  
9 the nature of the deposit liabilities which the  
10 banks assume. In other words, no very useful  
11 purpose would be served by the banks, for example,  
12 doing mortgage business at the expense of commercial  
13 lending which needs to be done and should be done,  
14 and which, if not done by the banks, will be done  
15 elsewhere in the financial system.

16 34. I think this is something that needs  
17 saying because of the disposition of the public  
18 occasionally to overlook the fact that the sound-  
19 ness of Canadian banking institutions, which is  
20 rather taken for granted, depends in the final  
21 analysis on an adequate degree of liquidity in  
22 banking assets. Bank deposits are to all intents  
23 and purposes demand obligations and banks must  
24 govern themselves accordingly. I am quite prepared  
25 to believe that, partly by reason of tradition  
26 and partly by reason of legal limitations of the  
27 nature I have been discussing, Canadian banks may  
28 have in the past been a little prone to over-  
29 emphasize the liquidity feature. But to maintain,  
30 as I do, that the banks should have room to take





1 on a modest proportion of longer term less liquid  
2 obligations is a far cry from suggesting that  
3 fundamental concepts of liquidity are now of  
4 little value and of no account.

5 35. I trust that these observations may  
6 be of interest to you as additional background  
7 to the more specific discussions which have already  
8 taken place. Should you wish to put any questions  
9 arising out of my comments I shall be glad to answer  
10 them to the best of my ability.

11  
12 \* \* \* \* \*







*Nethercut & Young*  
*Toronto, Ontario*

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7 SUBMISSION

8 TO

9 ROYAL COMMISSION ON BANKING AND FINANCE

10 July 1962

11  
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14  
15 . W. Earle McLaughlin

16 President, The Royal Bank of Canada  
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1  
2 1. I am most grateful to the Chairman and  
3 to the other distinguished members of the Royal  
4 Commission for this opportunity to express my views.  
5 In presenting a separate Brief, I do not wish to give  
6 the impression that this is some kind of dissenting  
7 "minority report" in which I take issue with the  
8 Brief already presented to the Commission by the  
9 President of The Canadian Bankers' Association on  
10 behalf of all the banks. Instead my purpose is to  
11 emphasize and to elaborate on certain points already  
12 raised in the CBA Brief.

13 GOALS, CONTROLS, AND COMPETITION

14 2. The financial system of any country must  
15 be regarded as one of the means towards the attain-  
16 ment of certain broad social or national goals of  
17 policy. One of these is closely associated with the  
18 traditional definition of "the" economic problem:  
19 the goal of an optimum (or most efficient) allocation  
20 of the nation's resources of labour, capital, and  
21 enterprise. Emphasis on this goal leads to emphasis  
22 on the importance of the free market mechanism, and  
23 to the general principle that, where policy  
24 alternatives exist, the choice should go to the one  
25 which involves the least (public or private)  
26 interference with the free competitive market. More-  
27 over, to the extent that we achieve this goal in the  
28 broad area of finance covered by this Commission, we  
29 shall make a contribution not only to the efficiency  
30 of our financial system but to the attainment of other







1 goals, more specifically identified with monetary  
2 policy, which enjoy so much current popularity.

3 I refer of course to "full employment", "economic  
4 growth" and the other goals, usually expressed in  
5 aggregates or averages, which the CBA Brief quite  
6 properly lists among the important objectives or  
7 achievements of a properly functioning monetary  
8 system.

9         3.         We should however distinguish between  
10 controls which, like monetary policy, are directed  
11 towards aggregates (such as the money supply)  
12 leaving competition and private decision-making free,  
13 and those which, like price ceilings or floors, are  
14 directed towards particular industries or sectors  
15 of the economy, inhibiting competition and private  
16 decision-making in the industries or sectors  
17 affected. As a general principle the latter type,  
18 i.e. specific controls and prohibitions, should be  
19 rejected in a predominantly free-market economy.  
20 Of course exceptions are inevitable: even monetary  
21 policy usually involves some specific interference;  
22 e.g., cash or liquidity reserve requirements may  
23 limit banks' freedom to allocate their assets to  
24 the best advantage. But more important still in this  
25 context, these specific requirements and prohibitions  
26 (even the apparently inevitable ones) interfere with  
27 and reduce the effectiveness of monetary policy.  
28 All who propose the extension or retention of such  
29 specific controls over the working of the financial  
30 system, or over other parts of the market economy,





1 should be required to bear the burden of proof.

2 4. Over the years, banks in all countries  
3 have become subject to extensive government  
4 regulation of the second variety; i.e., specific  
5 control over the nature and distribution of bank  
6 assets and liabilities. Some existing regulation  
7 originally arose to correct abuses in the early days  
8 of banking; other regulation seems to have derived  
9 from a general anxiety lest so important a sector  
10 of the economy might not always operate in the  
11 public interest. Presumably the public interest,  
12 which is seldom defined, includes in this case the  
13 welfare of depositors, shareholders and borrowers who  
14 are directly, though by no means exclusively,  
15 affected by the soundness and efficiency of the  
16 banking system. Moreover, the soundness and  
17 efficiency of the banking system is prerequisite  
18 to effective monetary policy and hence to the broader  
19 objectives which that policy is designed to achieve.  
20 In what follows I shall argue that the public  
21 interest in the sense defined is best served by  
22 substituting wherever possible a competition for  
23 regulation in the market for money and credit, and  
24 that this requires the removal of special advantages  
25 or handicaps that discriminate for or against any  
26 part of the financial system.

27 DEFINITION OF A BANK

28 5. The removal of a multiplicity of specific  
29 controls over the nature and distribution of bank  
30 assets or liabilities may have an incidental advantage





1 in simplifying the problem of defining what is and  
2 what is not a bank. Definition assumes practical  
3 importance if we apply specific controls of this  
4 nature to what we choose to call "banks" but do not  
5 apply them to what we choose to call "non-banks",  
6 or if we exempt what we choose to call "banks" while  
7 imposing certain specific controls on what we choose  
8 to call "non-banks". An inaccurate or inappropriate  
9 definition would then result in unfair discrimination  
10 (or at least discrimination not intended by the  
11 legislation) against one group or the other. If we  
12 free both groups from specific regulation of this  
13 sort, the practical necessity for detailed definition  
14 is at least open to doubt.

15 6. Banks could then be "defined" in terms  
16 of over-all monetary control: banks would be those  
17 institutions which, for the convenience and efficiency  
18 of monetary policy, keep their clearing accounts in  
19 the form of balances with the Bank of Canada.

20 7. The chartered banks form what we might  
21 call an "optimum clearing area" within the economy.  
22 Because of the high mobility of funds within the  
23 group, the size and frequency of the flow of funds,  
24 and the general acceptability of credit instruments  
25 representing claims on banks, the ends of monetary  
26 policy are furthered by treating the banking group  
27 in a special way: that is, as a means through which  
28 monetary policy reaches the economy as a whole.  
29 Other institutions accept deposits and make loans  
30 and, where mobility of funds exists within a group







1 of these institutions, they may form a separate  
2 clearing area. But ultimate settlement of claims for  
3 these clearing areas, as well as for unaffiliated  
4 institutions, is made through the chartered banks.  
5 Like the banking group, these non-bank clearing  
6 areas have a certain internal uniformity in cash  
7 needs, in their response to changes in cash, and  
8 in the size and frequency of fund flows within the  
9 group. However, because of the nature of their  
10 business, they differ in each of these respects from  
11 the banking group; and net flows in and out of the  
12 banking group are small relative to flows within the  
13 banking group. At the present time, therefore, the  
14 convenience and efficiency of monetary policy would  
15 in no way be furthered by including these institutions  
16 (or similar but unaffiliated institutions) in the  
17 banking group which have clearing accounts with the  
18 Bank of Canada.

#### 19 THE ROLE OF MONETARY POLICY

20 8. To suggest that we should move towards  
21 competition rather than regulation in financial  
22 markets is not to suggest that over-all monetary  
23 control be diminished, relaxed or eliminated. The  
24 use of open-market operations by the Bank of Canada  
25 to increase or decrease chartered-bank cash is  
26 compatible with full financial competition. The  
27 active part of this cash takes the form of  
28 chartered-bank deposits with the Bank of Canada  
29 and is in fact an economic variable of great  
30 significance in the economy. It is the one variable





1 in the financial system that is affected neither  
2 by the profit motive nor by impersonal market forces;  
3 i.e., it is varied solely at the discretion of the  
4 Bank of Canada. By expanding or contracting this  
5 variable the Bank of Canada can, through a process  
6 familiar to the Commission, expand or contract  
7 chartered-bank deposit liabilities which in turn  
8 make up almost 90 per cent of the total money supply.

9 9. In effect then Canada's money supply  
10 (defined as the total amount of chartered-bank  
11 deposits in Canadian currency plus Bank of Canada  
12 notes and Canadian coin in the hands of the public)  
13 is, except for purely temporary aberrations,  
14 completely responsive to Bank of Canada policy.  
15 However, the Bank does not, under present conditions,  
16 have effective control over what might be called  
17 "money-supply substitutes". These include deposits  
18 in various institutions such as Trust Companies,  
19 Caisses Populaires and Credit Unions, as well as a  
20 wide range of other claims issued by these and other  
21 financial institutions. This whole complex of  
22 institutions may be conveniently identified by the  
23 simple descriptive term "near-banks".

24 10. The competitive aspect of these  
25 operations, as seen by the chartered banks, has already  
26 been fully covered in the main CBA Brief. I would  
27 like in what follows to emphasize the implications  
28 for the monetary authorities not only of the growth  
29 of the near-banks but of a number of interrelated  
30 rigidities and imperfections, all of which work







1 together to reduce the efficiency of monetary policy.

2 MAKING MONETARY POLICY  
3 MORE EFFICIENT

4 11. The efficiency of monetary policy will  
5 tend to decrease to the extent that money-supply  
6 substitutes provided by near-banks grow relative  
7 to the money supply proper. Such growth has in  
8 fact been artificially stimulated, and the efficiency  
9 of monetary policy correspondingly reduced, by  
10 certain special rigidities; and here I refer  
11 specifically to the 6 per cent ceiling on bank  
12 loan rates of interest and the incidence of statutory  
13 and regulatory reserve requirements.

14 12. I do not wish to suggest that the growth  
15 of near-banks means that chartered-bank deposits  
16 are in some sense being "drained away". Near-bank  
17 growth does not of itself reduce the absolute size  
18 of the banking system. Initially, an increase in  
19 near-bank deposits or other claims changes the  
20 composition but not the total amount of chartered  
21 bank deposits. Chartered-bank deposit liabilities  
22 to the general public fall; chartered-bank deposit  
23 liabilities to Trust Companies, Credit Unions or  
24 other near-banks rise by the same amount. When  
25 the near-banks use their new funds for loans and  
26 investments, chartered-bank deposits owned by the  
27 general public rise, chartered-bank deposits owned  
28 by the near-banks fall by the same amount. However,  
29 it must be clear that in this operation, even though  
30 chartered-bank deposits remain unchanged in the





1 aggregate, the assets held by near-banks, and the  
2 claims issued by them to the public, have risen.  
3 In other words, even at this stage there has been  
4 a relative shrinkage of the banking system, and a  
5 relative increase in that part of the community's  
6 total liquidity represented by the money-supply  
7 substitutes provided by near-banks.

8 13. The growth in near-bank assets and  
9 liabilities has exactly the same effect on the  
10 economy as a similar expansion of the banking system.  
11 However, if this is natural growth, one would expect  
12 that, in the normal competitive process, the chartered  
13 banks would show a similar rate of growth. If not,  
14 the chartered banks would have only themselves to  
15 blame. However, normal competitive conditions do  
16 not prevail because certain official regulations  
17 weigh more heavily on banks than on near-banks.  
18 For example, near-banks are subject to less strict,  
19 or non-existent, cash-reserve requirements which give  
20 them a cost advantage over the chartered banks in  
21 the market for borrowed funds - i.e. deposits. In  
22 addition, the near-banks are not required to limit  
23 their loan rates to 6 per cent as provided in  
24 Section 91 of the Bank Act. They may therefore  
25 handle higher-cost loans not available to the banks.  
26 This too is reflected in higher near-bank deposit  
27 rates which the banks under existing limitations  
28 are unable to match.

29 14. Over an extended period of time, the  
30 central bank will presumably allow a gradual increase





1 in the money supply consistent with the long-run  
2 growth of the economy, but the increase in the money  
3 supply allowed will be influenced by the rate of  
4 near-bank growth. Hence artificial stimulation and  
5 abnormal expansion of money-supply substitutes will  
6 result in a smaller increase in the money supply,  
7 and a smaller rate of growth of the banking sector  
8 than would otherwise be the case. This long-run  
9 shrinkage of the banking sector relative to the  
10 system as a whole must ultimately result in a  
11 decline in the efficiency of monetary policy in  
12 performing its primary function - that of smoothing  
13 out cyclical movements in the short-run. A smaller  
14 "control base" means greater intervention for a given  
15 degree of stabilization, reflecting a corresponding  
16 decline in the efficiency of monetary policy.

17 15. In the short run too, near-banks gain  
18 an additional advantage when the Bank of Canada  
19 imposes "tight money" to combat a cyclical inflationary  
20 boom - or perhaps, with a fixed exchange rate, to  
21 prevent a loss of foreign-exchange reserves. At  
22 such a time, the banks are unable, under the present  
23 6 per cent ceiling, to use higher interest rates in  
24 any effective way to moderate the demand for bank  
25 loans. In the meantime, the near-banks, not so  
26 restricted, can raise interest rates to attract funds  
27 and pass on these higher costs in the form of higher  
28 loan rates of interest. In other words, under these  
29 conditions, the chartered banks with their total  
30 deposits restricted by monetary policy have to







1 restrict loans at a time when the near-banks can  
2 continue the process of loan and deposit expansion.  
3 As a result, monetary policy may have to become even  
4 more restrictive thereby further contracting the  
5 banking system - and so around again in a vicious  
6 circle. Under these conditions the growth of near-  
7 banks is literally at the expense of the chartered  
8 banks; i.e. chartered-bank deposits fall as near-  
9 bank liabilities rise.

10 16. What the banks lose under a restrictive  
11 monetary policy is not regained, or offset, in the  
12 recession phase of the cycle, when monetary policy  
13 is expansive. In the restrictive phase banks cannot  
14 follow the trend of rates upward; but in the  
15 expansive phase near-banks can follow rates downward.  
16 There is no need therefore for near-bank contraction  
17 relative to the banking sector in periods of easy  
18 money. In other words, the effects of restrictive  
19 and expansive monetary policies are not symmetrical  
20 over the cycle: there is a ratchet at work. Under  
21 tight money, near-banks gain, in effect, at the  
22 expense of the banks; but under easy money near-  
23 banks need not lose, and may therefore begin the  
24 next period of tight money, and near-bank expansion,  
25 in the same relative position which they had attained  
26 during the preceding tight money period.

27 17. Thus in both the short and the long run,  
28 monetary policy under the present limitations placed  
29 on banks tends to shrink the banking sector relative  
30 to the near-bank sector. In doing this monetary





1 policy becomes progressively less efficient:  
2 larger operations have to be undertaken to achieve  
3 a given effect on total liquidity in and outside the  
4 banking system. It might be argued that, in any case,  
5 the same effect is finally achieved. But the size  
6 of open-market operations required for a given effect  
7 is not a matter of indifference: there may be  
8 unpleasant side effects in the bond market. Bank  
9 of Canada open market operations, while necessary  
10 for effective monetary policy, should be reduced to  
11 a minimum. Greater intervention by the central  
12 bank made necessary by the declining efficiency of  
13 monetary policy threatens the independence and  
14 strength of our financial markets - thereby further  
15 reducing the efficiency of Bank of Canada operations.

16 18. The 6 per cent ceiling also has a  
17 direct effect on the efficiency of monetary policy  
18 which I think is now widely recognized. When market  
19 rates of interest are high during periods of  
20 monetary restraint, the banks are unable to implement  
21 the stated or implied aims of the central bank by  
22 using the price mechanism. They can neither raise  
23 the price of bank credit to secure an efficient  
24 allocation of the scarce supply of this particular  
25 resource, nor can they increase the price of funds  
26 borrowed from the public thereby rewarding saving  
27 and penalizing spending during a period of inflation.  
28 This is a most important aspect of the allocation  
29 of financial resources. The absence of an effective  
30 price mechanism during periods of monetary restraint







1 forces the banks to resort to the highly unpopular  
2 and necessarily arbitrary device of credit rationing.  
3 Thus the 6 per cent ceiling not only reduces the  
4 efficiency of monetary policy but ensures that any  
5 given effect achieved by monetary restraint will carry  
6 with it the additional burden to the economy of an  
7 uneconomic allocation of the scarce supply of credit  
8 available.

9 19. There are two ways, equally effective  
10 in themselves, of removing the artificial advantages  
11 or handicaps that now distort institutional growth  
12 in the financial system. We can universalize the  
13 handicaps, notably strict reserve requirements and  
14 the 6 per cent ceiling, that now apply only to the  
15 banks. Or we can universalize the advantages by  
16 extending to the banks the same freedom of action  
17 now available to the near-banks; i.e. we can reduce,  
18 adjust or abolish legal reserve requirements and  
19 eliminate the 6 per cent ceiling on bank loan rates  
20 of interest. But, though equally effective in  
21 themselves, these alternatives are not equally  
22 desirable. If we are to achieve an efficient  
23 allocation of our financial resources, our general  
24 principle applies, and we must choose the alternative  
25 that minimizes interference with the market mechanism.  
26 The right policy is not to impose handicaps on the  
27 near-banks; but to ensure the fullest degree of  
28 competition in the market for credit by extending  
29 near-bank freedom of action to the chartered banks.  
30





RESERVES FOR NEAR-BANKS?

20. However, if the financial system remains compartmentalized, if the banks are restricted to specific areas of finance, and especially if the 6 per cent restriction on bank lending rates remains on the statute books, then it may be necessary to resort to some universal system of reserve requirements in order to make monetary control effective. Under these conditions, ordinary market forces will be unable to operate fully to restrain the activities of all lenders. When market restraints are not permitted to operate, there is no alternative to direct controls.

21. Near-bank reserves are normally unaffected by open-market operations; and this would still be the case even if they took the form of clearing accounts with the Bank of Canada. It is the clientele of a near-bank, not the location of its clearing account, that determines its sensitivity to open-market operations. Therefore, to make the near-banks responsive to monetary policy through reserves, these reserves whatever their form would have to be varied upward or downward by means of variable requirements. I doubt that it would be wise to rely so heavily upon such a specific and direct control as variable reserve requirements in order to impose over-all monetary policy. Variable reserve requirements are in direct contradiction to our principle that specific controls involving direct interference with private decision-making should,





1 where possible, be rejected or minimized in a market  
2 economy.

3 22. Therefore, as I have already indicated  
4 (paragraph 19) I hope that it will be possible to  
5 move in the other direction. I believe that the best  
6 form of monetary control works through the market.  
7 We have achieved this to a large extent in Canada:  
8 the principal control measures of the central bank  
9 over bank cash are the Bank of Canada's open-market  
10 operations; and it is through these market operations  
11 that the Bank of Canada determines the size of the  
12 banking system. I would like to see the area of  
13 market control extended. I believe it can be  
14 extended, and the efficiency of monetary policy greatly  
15 increased, if we are willing to make two important  
16 changes in the competitive environment. The first  
17 change involves the reserve requirements of the  
18 chartered banks. The second, the present 6 per cent.  
19 ceiling on chartered bank loan rates of interest.  
20 I shall deal with them in turn.

21 RESERVES FOR CHARTERED BANKS?

22 23. The term "reserve" implies a source of  
23 bank liquidity and hence of safety for bank  
24 depositors. In fact, however, the higher the  
25 required cash, or other liquidity reserves, the less  
26 liquid the banking system becomes: i. e. the more  
27 of its resources are frozen in forms which cannot be  
28 availed of without breaking the law. The purpose  
29 of reserve requirements in Canada today is not the  
30 safety of depositors, which is nowhere seriously







1 questioned, but control over the money supply. The  
2 term "reserve" has become a misnomer which, in the  
3 interest of clarity in discussion, might well be  
4 replaced by a neutral term such as "cash ratio",  
5 or "liquidity ratio" to indicate the proportion of  
6 their deposit liabilities which banks are required  
7 by law, regulation, or custom to offset with cash  
8 or low-yield assets.

9 24. Effective control of the money supply  
10 through open-market operations does not require any  
11 legal reserve whatsoever. Banks must maintain cash  
12 in the form of deposits with the Bank of Canada to  
13 meet their clearings, and the Bank of Canada, by  
14 increasing or decreasing the banking system's working  
15 balances of cash through open-market operations, can  
16 control the total volume of chartered-bank deposits.  
17 A legal requirement of cash or other liquidity ratios  
18 above what the banks would voluntarily hold actually  
19 reduces the efficiency of monetary policy in two ways:  
20 first, it increases the amount of intervention  
21 required to bring about a given change in chartered-  
22 bank deposits; and, second (as pointed out in  
23 paragraph 14), it results in a long-run shrinkage of  
24 the banking system relative to near-banks, and hence  
25 in a reduction of that part of total liquidity under  
26 direct central-bank control. I would recommend  
27 therefore that the Commission consider either no  
28 legal cash or other liquidity ratios, or a nominal  
29 cash ratio only, which would not unduly penalize  
30 the banks. This would be in contrast to the present





1 legal requirement of an 8 per cent cash ratio and a  
2 voluntary 7 per cent secondary ratio. Since, as I  
3 have suggested, neither of these is necessary to  
4 effective monetary control, the amount of the primary  
5 reserve over and above the cash required for clearing  
6 purposes is a forced indirect interest-free loan to  
7 the Government and the secondary ratio is a forced  
8 allocation of a portion of the banks' assets into  
9 specific investments. All of this is contrary to  
10 my main thesis that the best policy is the one  
11 which involves the minimum of controls and interference.

12 25. Balanced growth of the financial system  
13 over the long run becomes possible if we have a  
14 reasonable degree of equality between banks and near-  
15 banks in required or voluntary cash ratios. But  
16 there is still the problem of equalizing the impact  
17 of monetary policy in the short-run; and this, in the  
18 absence of special controls on near-banks (which I  
19 do not recommend), becomes largely a problem of  
20 flexible interest rates.

21 26. I have already pointed out that open-  
22 market operations normally do not directly affect  
23 other financial institutions. Nevertheless, these  
24 institutions do depend on getting cash in other  
25 markets - the markets for savings - in which relative  
26 interest rates play an important part in determining  
27 how a given total of savings is allocated among  
28 various financial institutions. Interest rates  
29 throughout the money market should therefore be  
30 sufficiently flexible to extend the indirect effect







1 of open-market operations to include the near-banks.  
2 But this extension of monetary control to the near-  
3 banks through flexible interest rates depends on  
4 giving the banking system freedom to compete, especially  
5 freedom to alter interest rates as market conditions  
6 dictate. In other words, it requires a removal of  
7 the present 6 per cent ceiling on bank loan rates of  
8 interest. With such freedom, a restriction of bank  
9 cash would be followed by a rise in bank deposit and  
10 lending rates. Near-banks would then be unable to  
11 raise their borrowing rates in such a way as to  
12 widen any spread between chartered-bank rates and  
13 near-bank rates. The near-banks would be unable  
14 therefore to gain cash for expansion at a time  
15 when banks were being restrained. As a result, the  
16 impact of any future credit squeeze would be spread  
17 over all financial intermediaries. The impact of  
18 monetary policy would no longer be confined, as it  
19 is today, to the chartered banks alone. This  
20 would increase the efficiency of monetary policy  
21 by reducing the amount of central bank intervention  
22 necessary to attain a given policy objective.

23 27. I sincerely hope that the Commission  
24 will find my comments helpful in their deliberations  
25 in a range of inquiry which is of the greatest  
26 importance to the future of our country.





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S U B M I S S I O N

to the

ROYAL COMMISSION

on

BANKING AND FINANCE

Neil J. McKinnon

President

Canadian Imperial Bank of Commerce





1           The briefs submitted to the Royal Commission  
2   by the Canadian Bankers' Association and by many other  
3   groups and individuals have drawn attention to a  
4   variety of important problems concerning the financing  
5   of economic activity in Canada. It is the purpose of  
6   the first part of this submission to focus attention  
7   more directly on certain issues which affect in a  
8   fundamental way the future of the chartered banks in  
9   Canada. These issues also affect the economic and  
10   financial interests of the Canadian public, whether as  
11   suppliers of savings to financial institutions or as  
12   borrowers from such institutions. The point of view  
13   adopted here is that the true interests of all concerned,  
14   both the public and the various financial institutions,  
15   will best be served by developing the freest possible  
16   play of competitive market forces. Such competition  
17   will compel all those performing financial services of  
18   any type to maintain flexibility and adaptability in  
19   their operations in order to meet the growing and  
20   changing requirements of all segments of the Canadian  
21   community. Such competition will also tend towards  
22   the lowest economically feasible charges for financial  
23   services consistent with the basic elements of cost  
24   and risk involved and the highest average return to  
25   those who provide the savings which are fundamental  
26   to our economic and financial system.

27           The second part of this submission relates to  
28   the broadening of certain provisions of the Bank Act  
29   governing the issue of new shares of capital stock and  
30   to some considerations affecting the investment by the  
Pensions Funds of the banks in shares of Canadian  
chartered banks.







PART ONE

At the present time we have in Canada a considerable variety of financial institutions. In addition to the eight chartered banks, there are trust companies, instalment finance and small loan companies, mortgage loan companies, credit unions, Quebec Savings Banks, government savings institutions, life insurance companies, and the short-term money market. In this context, one should also refer to Government of Canada Savings Bonds since they are an important savings instrument directly involved in the competition for the community's savings, particularly when acquired under various instalment plans.

Each of these institutions has a role to play in the economic life of the nation, and each has developed, broadly speaking, in response to some need or opportunity which had not been adequately met by existing institutions. To some extent these various institutions have specialized roles to play, but to a growing extent they overlap and compete with one another. This is especially true on the deposit or borrowing side of their operations where they are all in competition for the community's savings. It is also true to a growing degree with respect to the lending or investment side of their operations, that is with respect to the way in which they employ the funds which they obtain. In one way or another, all provide financing to individuals, business, or to government. It would appear, therefore, that all of these financial institutions are engaged in broadly





1 the same category of business, that is, serving as  
2 financial intermediaries between those who have funds  
3 to lend or invest, on the one hand, and, on the other,  
4 those who have requirements for funds for personal,  
5 business, or governmental reasons. If this is the  
6 case, it would seem that the general terms or conditions  
7 upon which they are permitted to do business should be  
8 essentially the same and that the limitations imposed  
9 on banks which restrict them from offering all types  
10 of service of a banking or fiduciary nature should be  
11 removed. This would be desirable to ensure that full  
12 benefit could be obtained from the forces of competition.  
13 In such circumstances, those institutions which meet  
14 their customers' needs most efficiently and most  
15 economically would flourish, while the less efficient  
16 and less adaptable would face problems.

17 In practice, however, the Canadian chartered  
18 banks work under certain restrictions and limitations  
19 which do not apply to the other institutions. The  
20 chartered banks, alone among financial institutions,  
21 are listed as banks in the Canadian Bank Act and they  
22 are controlled in all their operations by the terms of  
23 that Act, which sets out in considerable detail what  
24 they may or may not do.

25 Section 91 of the Bank Act imposes a maximum  
26 of six per cent on the rate of interest which may be  
27 charged for bank loans. Section 75 prohibits the banks  
28 from lending money or making advances on the security  
29 of real immovable property. This prohibition has  
30 been modified to the extent that the banks may take







1 mortgage security under certain government-guaranteed  
2 lending schemes such as the National Housing Act and  
3 the Farm Improvement Loans Act. They may also take  
4 chattel mortgages in connection with loans to  
5 individuals. However, they are still completely  
6 excluded from the whole area of conventional mortgage  
7 lending, whether for private or business purposes.  
8 Under Section 71 of the Bank Act, the banks are also  
9 required to maintain a cash reserve in the form of the  
10 Bank of Canada notes held by each bank and deposits with  
11 the Bank of Canada, such reserves to be not less than  
12 eight per cent of the Canadian deposit liabilities of  
13 each bank. Under the Bank of Canada Act, the Bank of  
14 Canada is empowered to increase this reserve require-  
15 ment by stages up to 12 per cent of Canadian deposit  
16 liabilities. In addition to this eight per cent cash  
17 reserve and in the light of the power of the Bank of  
18 Canada to increase the reserve requirement to 12 per  
19 cent, the banks have further agreed with the Bank of  
20 Canada to maintain day-to-day loans to the money  
21 market and treasury bills in such amounts that the total  
22 of cash, day-to-day loans, and treasury bills shall be  
23 not less than 15 per cent of Canadian deposit  
24 liabilities.

25           These requirements as noted apply only to  
26 the eight chartered banks listed as banks in the Bank  
27 Act. Under the British North America Act the Parliament  
28 of Canada has exclusive power to legislate in respect  
29 of inter alia

30           (a) the regulation of trade and commerce;





- 1 (b) currency and coinage;
- 2 (c) banking, incorporation of banks, and the
- 3 issue of paper money;
- 4 (d) savings banks;
- 5 (e) bills of exchange and promissory notes;
- 6 (f) interest;
- 7 (g) legal tender.

8 While there is some federal legislation  
9 affecting other institutions besides the banks, for  
10 example, the Trust Companies Act, the Parliament of  
11 Canada has not exercised its authority to legislate  
12 detailed regulations and restrictions governing these  
13 other institutions to anything like the same extent  
14 as it has in the case of the banks. When the British  
15 North America Act was adopted in 1867 the great bulk  
16 of the financial transactions involving dealings in  
17 credit of all kinds, the obtaining of deposits from  
18 the public, the provision of chequing facilities on  
19 such deposits, and the making of loans and investments  
20 on the basis of such deposits, took place within the  
21 banking system as it then existed, that is within the  
22 chartered banks. At the present time, although a  
23 host of other financial institutions have developed  
24 which carry on business which is essentially of a  
25 banking nature, the authority vested in the federal  
26 authorities to control these matters has continued  
27 to be applied almost exclusively to the banks. This  
28 means, in effect, that functions performed under  
29 federal jurisdiction in 1867 have now in practice  
30 escaped from federal jurisdiction solely because they





1 are now performed by institutions which were unknown  
2 or relatively small in size at that time.

3  
4 As a consequence of this situation, financial  
5 institutions other than banks have been permitted  
6 substantial advantages in seeking both to obtain the  
7 community's savings in the form of deposits or loans  
8 of one kind or another, and, on the other side of  
9 their operations, in their efforts to serve as a  
10 source of financing for borrowers of all types. With  
11 respect to the earning power of these other institutions,  
12 it should be noted that insurance companies, trust  
13 companies, and other mortgage institutions are able  
14 to invest a substantial portion of their assets in  
15 conventional mortgages at rates in the vicinity of  
16 seven per cent and sometimes higher. Small loan  
17 companies and licensed money lenders are permitted,  
18 under the Small Loans Act, to make charges ranging  
19 up to one and two per cent per month on loans up to  
20 \$1,500, and there is no limitation on the rates  
21 charged for loans in excess of \$1,500. The Caisses  
22 Populaires in the Province of Quebec charge rates  
23 ranging up to nine per cent, usually including the  
24 cost of insurance, on loans to individuals, and they  
25 are also completely free to invest in mortgages of all  
26 kinds. Most credit unions outside the Province of  
27 Quebec charge one per cent per month on the unpaid  
28 balance of a loan. The assets of instalment finance  
29 companies are invested mainly in loan contracts at  
30 interest rates which may vary considerably but over which







1 there is no legislative control. Turning to two  
2 government-established financial agencies, the Central  
3 Mortgage and Housing Corporation rates on mortgages  
4 is now  $6\frac{1}{2}$  per cent, and it has been higher, and the  
5 current rate charged by the Industrial Development  
6 Bank is  $6\frac{1}{2}$  per cent on loans which, it should be  
7 noted, are secured by mortgages. The rate of the  
8 Industrial Development Bank, an institution subsidized  
9 by the taxpayers in that the capital and surplus are  
10 provided by the government through the Bank of Canada  
11 without any charge for dividends or other returns,  
12 has been as high as seven per cent for considerable  
13 periods of time, and the Act setting up this  
14 government bank specifies no maximum interest rate.  
15 The important point to note in connection with these  
16 examples is not so much that rates above six per  
17 cent per annum can be charged, for there is nothing  
18 special or remarkable about the rate of six per cent.  
19 Of prime significance is the fact that, unlike the  
20 banks, these institutions have flexibility to set  
21 their rates in accordance with market forces. If  
22 the "going rate" for a particular kind of business  
23 moves above six per cent per annum, they are not  
24 arbitrarily excluded.

25 It should be noted that the elimination of  
26 the ceiling on the lending rate charged by banks  
27 would not mean that the range of interest rates  
28 charged for various kinds of accommodation would be  
29 higher. In fact, it would almost certainly mean that  
30 a good many of the rates charged for various kinds of





1 transactions would be lower because it would become  
2 possible for the chartered banks to compete in new  
3 areas which are now effectively shielded from the  
4 force of competition from the banks. One example to  
5 illustrate this was the entry, a good many years ago,  
6 of The Canadian Bank of Commerce into the field of  
7 small personal loans to individuals repaid on a  
8 fixed and regular instalment basis. This program has  
9 made it possible for this bank to extend loans of  
10 modest size, for personal purposes, to individuals,  
11 many of whom because of lack of security or other  
12 risk factors would have had difficulty in obtaining  
13 ordinary bank loans and would have been forced to  
14 seek alternative sources of financing where the  
15 rates, on an annual basis, might have been anywhere  
16 from 12 per cent to 24 per cent, or even higher.  
17 The personal loan plan of The Canadian Bank of  
18 Commerce was set out in considerable detail before  
19 the Standing Committee of the House of Commons on  
20 Banking and Commerce at its meetings in 1954 preceding  
21 the last revision of the Bank Act. While it was made  
22 quite clear on that occasion that the effective  
23 average annual yield on such loans, on the basis of  
24 discounting them at six per cent, was, up to that  
25 time, 10.46 per cent, there was little inclination  
26 on the part of any of those then concerned with  
27 reviewing these matters to argue that the public  
28 interest would be better served if these borrowers  
29 were forced to seek accommodation at much higher  
30 rates from alternative sources. The initiation of







1 this service by one bank also led to the creation of  
2 similar services by others. This is of course only  
3 an example and it deals with a relatively small  
4 proportion of a bank's total business. The point at  
5 issue is that the legal maximum ceiling on bank loans,  
6 if it ever had any valid justification, related to a  
7 much earlier period in our history when banks were  
8 virtually the only financial institutions in the  
9 country. Any realistic assessment of the present  
10 situation must lead to the conclusion that the  
11 considerable network of competing financial  
12 institutions is now well established and is here to  
13 stay. Interest rates on all classes of transactions  
14 should be set in the market by the free play of  
15 competition among all the various types of  
16 financial institutions. The ceiling on the interest  
17 rate which can be charged by one of the competing  
18 types of institutions is a relic of the past which  
19 does not safeguard any public interest, but, in fact,  
20 serves to reduce the amount of competition which  
21 non-bank institutions have to meet, and therefore  
22 tends to keep some rates higher than they would  
23 otherwise be. This seriously restrains the  
24 chartered banks in adapting their operations in  
25 a flexible and competitive way to meet the changing  
26 opportunities and growing challenges of a complex  
27 society.

28 The continuing restriction under Section 75  
29 on the right of the banks to take mortgage security  
30 has an effect on their operations similar in many ways





1 to the six per cent restriction. The traditional  
2 justification for the prohibition of mortgage lending  
3 on the part of the banks has been the emphasis on  
4 the banks' need for liquidity. The banks must at  
5 all times be prepared to meet their deposit liabilities  
6 on demand, and they must therefore have appropriately  
7 balanced asset holdings which ensure the necessary  
8 liquidity. This question was canvassed at the time  
9 of the 1954 revision of the Bank Act when the Act  
10 was amended in order to permit the chartered banks  
11 to give effect to the intentions of the National  
12 Housing Act of 1954, which listed the chartered banks  
13 as one of the approved lenders under the Federal  
14 Government's housing program. On that occasion the  
15 Governor of the Bank of Canada, Mr. Graham Towers,  
16 indicated clearly that in his view the investment  
17 in mortgages of a "moderate percentage of savings  
18 deposits" would not impair the liquidity of the  
19 banks.\* In reply to a question as to whether he  
20 thought the prohibition of direct bank lending on  
21 mortgage security should be lifted, Mr. Towers  
22 replied, "Yes, and I have felt that way for many  
23 years."\*\*

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24  
25 \* The 1954 Proceedings of the Banking and Commerce  
26 Committee (regarding Bill 102 to revise the  
27 National Housing Act), page 254.

28 \*\* The 1954 Proceedings of the Banking and Commerce  
29 Committee (regarding Bill 102 to revise the  
30 National Housing Act), page 269.





1 It is also of interest that Mr. Towers indicated at  
2 the same time that in his opinion the holdings of  
3 residential amortized mortgages had not been an  
4 important element in the difficulties experienced by  
5 many United States banks in the early 1930's, and  
6 suggested that, in fact, the loss ratio on such  
7 assets had been extremely low.

8 To summarize the results of mortgage lending  
9 operations by the chartered banks under the National  
10 Housing Act from the revision in the Bank Act in  
11 1954 to the end of 1959, mortgages approved by all  
12 sources totalled \$3,690 million, of which about  
13 \$1,292 million were assumed by the chartered banks.  
14 In addition, substantial portfolios representing  
15 mortgages were held and administered for others.  
16 These figures attest to the positive attitude taken  
17 by the banks towards National Housing Act mortgage  
18 lending with the result that very substantial amounts  
19 of private funds were made available to this industry  
20 at a time when such financing was badly needed.  
21 However, the 1954 amendment to the Bank Act to make  
22 it possible for the banks to take on National Housing  
23 Act mortgages, as an exception to the general and  
24 continuing prohibition on mortgage lending, did not  
25 take into account the other main rigidity in the  
26 Bank Act, the six per cent ceiling. In December  
27 1959 the going rate for mortgage lending under the  
28 National Housing Act was raised by the Government  
29 to 6 3/4 per cent per annum, and although the banks  
30 had previously suspended such lending temporarily







1 because of insufficient resources at the time, the  
2 consequence of the rate change has been that the banks  
3 have since been effectively eliminated from the field.

4 This relatively short period of active  
5 involvement in mortgage lending did, however,  
6 illustrate that the chartered banks could engage in  
7 this business in a substantial way without impairment  
8 of their liquidity and it also served to give the  
9 banks a good deal of operating experience in this  
10 area. Over the years some banks have also acquired  
11 a considerable experience in the field of conventional  
12 mortgage lending through the investment of a portion  
13 of their employee pension funds in good quality  
14 conventional mortgage loans.

15 If the banks were free to charge the going  
16 rate for mortgage loans and to acquire mortgages,  
17 whether National Housing Act or conventional (that is,  
18 if the prohibition in Section 75 was eliminated  
19 completely), it seems clear that their experience  
20 in this field indicates that they are well qualified  
21 to provide their customers with a full range of  
22 mortgage loan services without impairment of their  
23 ability to continue to participate fully in other  
24 lending and investing activities as well. There are  
25 many reasons why it would be desirable in the public  
26 interest to enable the banks to compete freely in the  
27 whole area of mortgage lending. Under existing  
28 conditions the mortgage lending field is largely  
29 shielded from any competition from the banks, and  
30 it would seem only reasonable to expect that the





1 ability of the banks to enter into this field would  
2 have the effect on mortgage lending rates which might  
3 normally be anticipated from increased competition  
4 and an increased supply of available funds.

5 It has also been emphasized during some  
6 of the hearings of the Royal Commission that there  
7 tend to be gaps in the availability of mortgage  
8 financing under present circumstances. One such gap  
9 relates to term loans of various kinds to small  
10 businesses where ability to take mortgage security  
11 would tend to make bank financing more feasible.  
12 Another example of such a gap is with respect to  
13 resale financing of older homes. This is an important  
14 area where financing under the National Housing Act  
15 is not available, but where some degree of participation  
16 by the chartered banks would be both feasible and  
17 desirable if the present restrictions was removed.  
18 A large volume of total home purchases must  
19 necessarily be financed by conventional mortgages.  
20 A participation by the banks even of a modest  
21 proportion of savings deposits in this field would  
22 provide a valuable service to the public.

23 It is interesting to note in passing that  
24 in the United States national banks at one time were  
25 also prohibited from lending on real estate, with the  
26 consequence that trust companies, state banks, and  
27 savings and loan associations of various kinds  
28 developed very rapidly, taking advantage of the  
29 preferred position in which they found themselves as  
30 the result of this restriction on the national banks.







1 Commencing in 1913, however, the restriction on  
2 mortgage lending by national banks was gradually  
3 lifted. At the present time, the national banks in  
4 the United States may hold real estate loans amounting  
5 to 60 per cent of their time and savings deposits.  
6 It must be emphasized, of course, that savings  
7 deposits are a much smaller percentage of the total  
8 deposits of United States banks than is the case  
9 in Canada. At the present time in Canada some 60  
10 per cent of total Canadian dollar deposits of the  
11 chartered banks are in the form of personal savings  
12 accounts or other notice deposits. Comparable  
13 "time deposits" for all United States commercial  
14 banks are currently equal to about one-third of  
15 total deposits. Assuming freedom to do so, the  
16 extent of its investment in mortgage assets of all  
17 kinds by a particular bank would be a matter of  
18 judgment by its management, but it would be unlikely,  
19 at least in the early years of such a development,  
20 that the assets so invested would exceed 20 per cent,  
21 or at most 30 per cent, of the bank's savings deposits.  
22 Here again it should be reiterated that the other  
23 institutions in this field are well established and  
24 well able to meet competition from any source.  
25 Nothing that has been suggested here would tend to  
26 eliminate them from the field or to reduce their  
27 competitive effectiveness. It is only suggested  
28 that the banks with their widespread network of  
29 branches, located in all areas of the country and  
30 not concentrated only in the larger centres, should





1 be in a position to offer mortgage loans, in addition  
2 to other forms of financial accommodation, to the  
3 Canadian public.

4 This conclusion derives also from the  
5 traditional nature of Canadian banking. Canadian  
6 banks are both savings banks and commercial banks.  
7 The total of personal savings deposits in chartered  
8 banks at the present time is in excess of \$8 billion,  
9 and in addition there are approximately \$900 million  
10 in other notice deposits. In most countries, such  
11 savings deposits normally provide the foundation for  
12 housing loans and other longer-term investments.  
13 It is scarcely logical now in view of the growth  
14 of the financial system that Canada should be perhaps  
15 the only country where chartered banks face these  
16 restrictions on mortgage lending when Canadian bank  
17 deposits include such a remarkably high proportion  
18 of savings deposits. While it is neither necessary  
19 nor desirable for the effectiveness of this proposed  
20 measure to envisage any rigid separation of savings  
21 deposits from other deposits in looking at a bank's  
22 over-all operation, it remains true that savings  
23 deposits in the aggregate are a relatively stable  
24 and long-term element on a bank's books and it is  
25 therefore reasonable and appropriate that at least  
26 a proportion of these savings deposits should be  
27 invested in relatively longer-term instruments,  
28 particularly in conventional and other mortgages.  
29  
30







1 Since the average yield on such investments is some-  
2 what higher than that which can now be obtained on the  
3 bulk of a bank's assets, the first consequence of  
4 such a move would be greater ability on the part of  
5 the banks to pay higher interest rates to the public  
6 on savings deposits. If the banks are to continue  
7 to offer effective competition to other institutions  
8 in the financial field, it is essential that they  
9 be in a position to earn higher rates on a proportion  
10 of their assets invested in this way so that they may  
11 pay competitive returns on savings deposits.

12 When one looks at the relative rates of  
13 growth of chartered banks and competing financial  
14 institutions, it is clear that, for the reasons  
15 already set out, the chartered banks are not progress-  
16 ing as rapidly as the other institutions because of  
17 the restrictions imposed by the Bank Act on their  
18 ability to compete. The tables included on pages  
19 187 and 188 of the brief of The Canadian Bankers'  
20 Association show the steady decline in the postwar  
21 years of the share of the community's funds  
22 available for savings or investment which have gone  
23 into the chartered banks compared with the share  
24 going into other financial intermediaries. From  
25 1955 to 1960, the Canadian dollar deposits of  
26 chartered banks increased by slightly over 19 per  
27 cent. By contrast, in the same period, the shares  
28 and deposits of credit unions increased by 98 per  
29 cent, the deposits and certificates of 17 trust  
30 companies increased by 90 per cent, the deposits







1 and debentures of seven mortgage companies increased  
2 by 60 per cent, and the notes and debentures of  
3 finance companies increased by 89 per cent.

4 The total savings in 1947 deposited with  
5 credit unions, trust companies and mortgage companies  
6 amounted to \$625 million, and these had grown by  
7 1960 to \$3,025 million. The comparable increase of  
8 chartered bank notice deposits was from \$3,740  
9 million to \$7,791 million. During the same period,  
10 savings in credit unions as a percentage of the total  
11 amount of savings held by credit unions, trust  
12 companies, mortgage loan companies and chartered  
13 banks, increased from 4.7 per cent to 11 per cent.  
14 The comparable increase for trust companies in the  
15 same period was from 5.3 per cent of the total to  
16 10.1 per cent of the total, and for mortgage loan  
17 companies from 4.3 per cent to 6.8 per cent of the  
18 total. These three types of institutions together  
19 in 1947 held 14.3 per cent of the total savings  
20 deposits held by themselves and the chartered banks.  
21 By 1960 their share of this total had grown to 27.9  
22 per cent. During this same period, the share of  
23 notice deposits in chartered banks, as a proportion  
24 of the total of chartered bank notice deposits plus  
25 savings in credit unions, trust companies, and  
26 mortgage loan companies had declined from 85.7 per  
27 cent to 72.1 per cent.

28 There are obvious difficulties in the way  
29 of any attempt to project these trends into the  
30 future, using the rates of growth of, for example,





the last five years or so, and the figures which result can be taken only as illustrations of the general nature of developments if present trends and existing limitations on the powers of the chartered banks to do business continue. However, using the rates of growth for the period 1955 to 1960, a projection of total deposits and similar obligations of chartered banks, trust companies and credit unions would be as follows:

<u>1960</u>	<u>1956</u> <sup>1965</sup>	<u>1970</u>	<u>1975</u>	<u>1980</u>	<u>1985</u>	<u>1990</u>
(millions of dollars)						
12,921	15,376	18,297	21,773	25,910	30,833	36,691
Chartered Banks						
1,195	2,366	4,685	9,276	18,366	36,365	72,003
Credit Unions						
1,091	2,073	3,939	7,484	14,220	27,018	51,334
Trust Companies						

In absolute terms, the chartered banks' share of the savings deposit business is still large, but the significant point is that the rate of growth of other institutions in the field is substantially greater than that of the chartered banks, and the share of the community's total money deposits going into the chartered banks is declining steadily on a long-term basis. A fundamental reason for this trend is the ability of the competing institutions to pay more attractive rates on savings deposits. A complementary reason, no doubt, is that other financial institutions benefit to some extent from the reputation of safety and security built up over the years by the chartered banks. The feeling that savings can be entrusted with complete confidence to the banks has







1 undoubtedly influenced in a favourable way the public's  
2 attitude towards placing their savings with other  
3 institutions. Thus they benefit to a considerable  
4 extent from a climate of public opinion which has been  
5 built up over the decades by the record of the Canadian  
6 chartered banks.

7         These developments have clear implications  
8 for the nation's monetary policy. If the growth  
9 in other depositories who offer banking services,  
10 relative to the growth of chartered banks, should  
11 show the same trend in the years to come as over the  
12 past five years the size of the deposit and banking  
13 institutions outside the influence of the central  
14 bank eventually will become greater than those within  
15 it. Based on the trends of recent years this is  
16 likely to take place if existing limitations imposed  
17 on the chartered banks continue and it would follow  
18 that rigidities in the market would impair the free  
19 working of the monetary system. Under these  
20 circumstances the influence exercised by the central  
21 bank in its monetary policy would gradually diminish.

22         The Bank of Canada's obligation, in the very  
23 general terms of the preamble of the Bank of Canada  
24 Act, is -

25         ". . . to regulate credit and currency  
26         in the best interests of the economic  
27         life of the nation, to control and  
28         protect the external value of the  
29         national monetary unit and to mitigate  
30         by its influence fluctuations in the





1           general level of production, trade,  
2           prices and employment, so far as may  
3           be possible within the scope of  
4           monetary action, and generally to  
5           promote the economic and financial  
6           welfare of the Dominion."

7       In practice, the Bank of Canada's only direct control  
8       over credit conditions in the country as a whole  
9       is its control over the cash reserves of the chartered  
10      banks. By virtue of its power to buy and sell  
11      Government of Canada securities as well as a number  
12      of other market instruments, the Bank of Canada, by  
13      its market operations, can add to or subtract from  
14      the cash reserves of the chartered banking system  
15      as a whole. The operation of the reserve requirements  
16      outlined above means that total chartered bank deposits,  
17      and consequently total chartered bank assets, can be  
18      controlled in size by these Bank of Canada operations.  
19      In the words of the brief submitted by the Bank of  
20      Canada to the Royal Commission on Banking and Finance:

21           "The central bank operates only at the  
22           centre of the financial system -- the  
23           Government securities market and the  
24           cash reserves of the chartered banks --  
25           and it relies on the impersonal  
26           functioning of financial markets to  
27           transmit the effects of its policies  
28           through the rest of the economy."\*

---

\* Submission by the Bank of Canada to the Royal  
Commission on Banking and Finance, page 21, para. 61.





1 At another point in its brief, the Bank of Canada  
2 asserts that:

3 "A central bank can exert a pervasive  
4 effect on credit conditions even though  
5 the direct effects of its operations are  
6 confined to the cash reserve position  
7 of the commercial banks and to the market  
8 for short-term Government securities."\*\*

9  
10 \*\* Ibid: page 28, para. 18.  
11

12 The fact that the chartered banks are the  
13 sole means through which monetary policy is trans-  
14 mitted has various consequences. At a time when  
15 chartered bank operations constituted an overwhelm-  
16 ingly large proportion of total financial activity  
17 in the country, this may have been justifiable. In  
18 present circumstances, however, the ready avail-  
19 ability of many alternative sources of credit means  
20 that when credit restrictions are applied to the  
21 chartered banks, through the mechanism of reserve  
22 requirements and the Bank of Canada's market  
23 operations, the immediate consequence is that the  
24 business done by competing institutions tends to  
25 expand to fill the gap. This situation is accentuated  
26 by the fact that in a period of credit stringency,  
27 with accompanying higher interest rates, the other  
28 institutions are not limited by a six per cent  
29 ceiling. It cannot be assumed, therefore, that the  
30 "impersonal functioning of financial markets" will







1 in fact transmit the effects of the Bank of Canada's  
2 policies in an effective or equitable way through  
3 the rest of the economy. In fact, a further quotation  
4 from the brief of the Bank of Canada might be used to  
5 illustrate the rather unsatisfactory nature of this  
6 assumption. After describing the possible use of  
7 varying the minimum cash reserve or the liquid asset  
8 ratio for chartered banks as an additional measure,  
9 along with the normal techniques of cash management,  
10 to place a restraining influence on excessive demands  
11 for credit, the brief contains the following interest-  
12 ing paragraph:

13 "Such a policy would not succeed in  
14 accomplishing much if the unsuccessful  
15 applicants for bank credit merely  
16 turned up elsewhere in the market to  
17 press their demands for credit. However,  
18 there are substantial imperfections and  
19 much inertia in credit markets and it  
20 is a reasonable assumption that many of  
21 the disappointed bank borrowers would  
22 either fail to search out and find  
23 alternative sources of credit or would  
24 be deterred, at least in part from pressing  
25 their full demands through unwillingness  
26 to accept stiffer credit terms."

27 It is difficult to share the view that a significant  
28 number of bank customers would give up so easily.

29 Another aspect of the adverse differential  
30 effect on chartered banks of reserve requirements,





1 both cash and liquidity, is the simple effect of  
2 these requirements on the banks' earning assets.  
3 Alone among the whole range of competing institutions,  
4 chartered banks are required to keep an amount of  
5 their assets equal to at least 15 per cent of their  
6 Canadian deposit liabilities in a form which produces  
7 either no income, the cash component, or a relatively  
8 low yield, the additional obligatory percentage held  
9 in the form of day-to-day loans to the money market  
10 and treasury bills. The banks' true reserves, either  
11 in cash or highly liquid short-term assets which can  
12 quickly be turned into cash, and which are needed in  
13 order to meet the cash demands of our customers, and  
14 on which earnings consequently are low, must be in  
15 excess of the mandatory 15 per cent, and, therefore,  
16 this large amount is not in practice available for  
17 use.

18 In the words of the United Kingdom Radcliffe  
19 Report\*, the institutions discussed in this brief  
20 survey, including the chartered banks, are all:

21 ". . . in active competition for funds,  
22 and all supply finance to borrowers of  
23 different kinds. They make up what we  
24 may refer to as 'the financial sector'  
25 of the economy, a phrase which emphasises  
26 the importance of examining the activities  
27 of each institution in relation to the  
28 others and not in isolation from them."

---

30 \*Report of Committee on the Working of the Monetary  
System, page 107.







1 In this section of its report the Radcliffe  
2 Commission deals with such institutions as the  
3 joint stock banks, insurance companies, pension  
4 funds, building societies, investment trust, hire  
5 purchase, and finance houses. These are described  
6 in the report as "...the main groups of institutions  
7 in the monetary system whose behaviour can be  
8 expected to have appreciable influence upon the  
9 facility with which, and the terms upon which,  
10 people can obtain finance ..." and which are  
11 "...the main channels through which finance passes  
12 from lenders to borrowers." A further quotation  
13 from the Radcliffe Report is also instructive:

14 "We have included all these groups of  
15 institutions in one chapter, despite  
16 the great differences in the activities  
17 which they undertake and the types of  
18 credit they offer, because we have been  
19 impressed in hearing evidence not by these  
20 differences but by the fact that the market  
21 for credit is a single market. Though  
22 each type of institution has its special  
23 type of business and may, by tradition  
24 or as a matter of commercial arrangement,  
25 state a preference for one form of lending  
26 rather than another, it does not seem that  
27 any hard and fast lines are drawn, for  
28 instance between the supply of short  
29 finance and the supply of long finance;  
30 and borrowers seem to be ready to switch





1 to some extent from one to another  
2 if difficulties are put in the way of  
3 their obtaining finance from the source  
4 upon which they are accustomed to draw."\*

5 In the United Kingdom, of course, there is no  
6 comparable ceiling on the interest rate chargeable  
7 by banks nor on the kind of security which may be  
8 taken and this contributes to a greater mobility and  
9 flexibility in the financial system as a whole.

10  
11 \* Report of Committee on the Working of the Monetary  
12 System, page 42.

13  
14 These references emphasize the conclusion  
15 of the able and distinguished committee of enquiry  
16 headed by Lord Radcliffe that all such financial  
17 institutions are engaged in fundamentally similar  
18 operations. This point of view contrasts sharply  
19 with the distinction in Canada between banks and  
20 other financial institutions. The distinction is  
21 fully understandable on historical and traditional  
22 grounds, but in present circumstances it is entirely  
23 arbitrary. The legislative position in Canada is  
24 such that only the chartered banks are under the  
25 controls established by the Bank Act and the Bank of  
26 Canada Act, even though many other institutions now  
27 carry on essentially similar operations as financial  
28 intermediaries of one kind or another. Because of  
29 this situation there has already been a good deal  
30 of legal argument and discussion as to the definition





1 of banking, one of the subjects on which the Federal  
2 Parliament has exclusive power to legislate. If  
3 banking were defined so as to cover all those  
4 institutions which perform the functions of a  
5 financial intermediary (and this, is, by implication,  
6 the approach revealed in the above citations of the  
7 Radcliffe Report) there is little doubt that many  
8 of the operations of financial institutions other  
9 than banks would come more directly under the  
10 jurisdiction of the federal authorities. Indeed,  
11 as has been pointed out above, this may in the end be  
12 necessary if the Government and its agency, the Bank  
13 of Canada, are to succeed in carrying out effective  
14 monetary policies. In this connection, another  
15 problem which arises is that of compliance with  
16 monetary policy by foreign-owned financial institutions.  
17 It has been apparent in past periods of credit  
18 stringency that, for example, foreign-owned finance  
19 companies, having outside sources of funds, have not  
20 been under even the indirect restrictions which  
21 influence other non-bank financial institutions.

22 For present purposes, however, it is  
23 sufficient to make it clear that these other  
24 institutions are in various ways in the same  
25 business and in competition with the chartered banks.  
26 Such competition is welcome and desirable in the  
27 broadening of financial facilities available to the  
28 public; the development of a range and variety of  
29 financial institutions to serve the needs of the  
30 public is in itself beneficial. On the grounds







1 of serving the public effectively and of equity,  
2 however, there can be a fundamental objection to  
3 having one set of these institutions, the chartered  
4 banks, subjected to stringent restrictions which do  
5 not apply to the other institutions. If these  
6 restrictions were in themselves useful and served a  
7 valuable public purpose, the logical solution would  
8 be to apply these rules as equitably as possible to  
9 all competing financial institutions. In fact,  
10 however, at least two of the restrictions, the  
11 prohibition of mortgage lending and the ceiling of  
12 six per cent per annum on the charge for bank loans,  
13 serve no useful public purpose and therefore should  
14 be eliminated. It would indeed be a reductio ad  
15 absurdum to apply these restrictions to financial  
16 institutions in general since mortgage money must  
17 come from somewhere and market pressures would  
18 inevitably produce other sources of credit where  
19 a demand existed that could not be satisfied within  
20 the rigid limits of the six per cent ceiling.

21 The question of applying monetary policy  
22 to all other financial institutions in a more direct  
23 and effective way raises problems which will have to  
24 be faced and solved in the long run interests of  
25 the nation. Careful consideration should be given  
26 to requiring that variable cash reserves, comparable,  
27 in relation to the nature of the business done, to  
28 those required of the chartered banks be maintained  
29 by all institutions seeking deposits from the  
30 public and offering various kinds of banking services.



1 Unless steps to this end are taken, perhaps on a  
2 progressive basis and beginning with the larger and  
3 more readily controllable institutions, the effective-  
4 ness of monetary policy measures undertaken by the  
5 federal authorities will probably diminish.

6 Professor R. S. Sayers, one of the members of the  
7 Radcliffe Committee, emphasizes this point in an  
8 article in The Banker for October 1960. He argues  
9 that the restriction of the supply of bank deposits  
10 as an instrument of monetary policy can be expected  
11 to become increasingly ineffective in curbing total  
12 demand because the demand for liquidity can be so  
13 well satisfied from other sources. He goes on to  
14 make the point that as the banks lose ground to  
15 other competitors the institutions on which the  
16 monetary authorities can exert pressure, that is  
17 the banks, will become progressively less influential  
18 in the behaviour of the economy. The Bank of Canada  
19 brief in the passage quoted above at least implies  
20 a similar concern by indicating that in carrying  
21 out monetary policy under present circumstances  
22 reliance must be placed on so uncertain and dubious  
23 a factor as the lack of persistence on the part of  
24 disappointed bank customers in seeking accommodation  
25 elsewhere.

26 If nothing is done to rectify this situation,  
27 both as to the specific prohibitions in the Bank Act  
28 and the general burden and operation of monetary  
29 policy, the natural consequence will be that the  
30 chartered banks will either have to accept a long-term







1 decline in their relative position and competitive  
2 impact in the financial sector of the economy, or  
3 they will be compelled by competition to seek ways  
4 of participating indirectly in the fields which are  
5 denied them under present legislation. One sign of  
6 this development is already apparent in the share  
7 ownership of some of the chartered banks in some of  
8 the trust companies. Other signs are the establish-  
9 ment of new organizations under the general super-  
10 vision of or in association with banks to enter into  
11 the field of longer-term lending involving mortgage  
12 securities and interest levels in excess of the rate  
13 provided in the Bank Act. Under the existing  
14 limitations imposed by the Bank Act these develop-  
15 ments come about to serve a public demand. The  
16 maintenance of a condition under which banks are  
17 impelled to seek effective control of other  
18 institutions in order to provide indirectly services  
19 and facilities which they may not provide directly  
20 does not result in the most useful kind of evolution  
21 in the financial system nor does it encourage the  
22 offering of all the services of which the banks are  
23 capable through all their branches in communities,  
24 small as well as large, in all parts of the country.

25 The recommendations made in this submission  
26 will in my view increase the scope and variety of  
27 competitive services offered to the public. This  
28 cannot fail to be in the interest of the general  
29 public whether as suppliers of savings or as  
30 applicants for credit.





PART TWO

The Bank Act includes provisions requiring --

1. That an offering of rights to shareholders to subscribe to new shares must be made at a price calculated under a prescribed formula which has the effect of pricing the new shares at the book value of presently outstanding shares less undivided profits,
2. That all additional shares be offered pro rata to existing shareholders,
3. That, except with the consent of the Treasury Board, a bank may not contribute to any pension fund if any part of the fund has been invested in the capital shares of a bank.

1. Commenting first on Item 1, the existing formula compels banks to offer new shares at an abnormally deep discount off market price.

This restriction does not apply, as far as I know, to any other type of Canadian corporation raising funds by "rights" method. The historical reason for the restriction appears to go back to the "double liability" feature of bank shares, which was removed from the Bank Act a number of years ago with the





1       discontinuance of currency issues by the banks.  
2       There would seem to be no reason why the boards of  
3       directors of banks should not have authority similar  
4       to that of corporations in establishing the price  
5       of new shares. Bank shareholders have, perhaps,  
6       become accustomed in the past decade to a deep  
7       discount in respect of rights issues, but in the  
8       long run the best interests of shareholders are not  
9       served by a provision which unduly raises the cost  
10      of new capital.

11      2.       Referring to Item 2, it is, of course, the  
12      general practice of most companies to offer new  
13      shares pro rata to existing shareholders and I would  
14      suggest that, without altering this basic principle,  
15      the powers of boards of directors of banks be  
16      enlarged to enable them, subject to appropriate  
17      safeguards, to make provision for the issue of  
18      additional shares for stock purchase and stock  
19      option plans for employees and officers.

20              It is, of course, common knowledge that  
21      insurance companies, trust companies, finance  
22      companies, and most industrial enterprises all draw  
23      from a common source for employees. It is not as  
24      widely recognized that competition for promising  
25      management talent has become much keener than it  
26      once was, due perhaps, to improved screening  
27      techniques at initial employment and at each  
28      promotion and to more exacting standards for  
29      executive capacity and performance. Organizations  
30      unable to offer a well balanced and flexible stock







1 purchase plan may find themselves at a competitive  
2 disadvantage in attracting potential management  
3 talent in view of the growing use of such plans in  
4 the business world. The rules and permissible  
5 conditions under Canadian income tax law, enacted  
6 in 1953, make provision for the granting of stock  
7 options to individuals by their employers and a  
8 number of corporations have resorted to the arrange-  
9 ment in efforts to attract or retain qualified  
10 management personnel.

11 A somewhat parallel situation affecting the  
12 national banks in the United States is concurrently  
13 being rectified to make them more competitive in the  
14 employment market. There the Advisory Committee on  
15 Banking to the Comptroller of the Currency recently  
16 conducted a comprehensive study of the functioning  
17 of the national banking system of the United States,  
18 and as part of its findings the Committee has  
19 recommended that national banks be empowered to offer  
20 stock acquisition plans to their officers and  
21 employees under certain safeguards. These safe-  
22 guards would include approval of individual plans  
23 by the Comptroller of the Currency in addition to  
24 the normal approval of the directors and shareholders  
25 of the bank. A change in regulations authorizing  
26 federally supervised banks to offer such plans now  
27 is, I believe, scheduled to become effective before  
28 February 1, 1963.

9 The problem has another aspect. Stability  
0 of employment, health and welfare benefits, pension





1 plans, and various other long established advantages  
2 of bank employment in this country have become much  
3 more widespread than they once were and no longer  
4 offer the degrees of preferences in bank employment  
5 that they did some years ago. The benefits the bank  
6 provides are evaluated by officers and employees in  
7 terms of job security and scope for advancement but  
8 this does not always evoke the degree of extra effort  
9 that is needed for the highest standard of performance  
10 and progress in an increasingly competitive world.

11 Additional incentives in the form of appropriate  
12 employees' stock acquisition plans similar to those  
13 successfully used by other corporations in Canada  
14 could prove beneficial not only to employees and the  
15 bank as an institution but to the users of bank  
16 services as well.

17 3. The provision referred to in Item 3 was  
18 incorporated in the Bank Act in 1954. The Pension  
19 Fund of the bank I represent has never to my knowledge  
20 invested in the shares of any of the Canadian chartered  
21 banks and for many years the trustees of the Fund  
22 held the view that it would be inadvisable to do so  
23 on the principle that the assets of the Fund which  
24 are administered in trust for its members should not  
25 include an investment in the shares of the bank  
26 itself. The trustees have in recent years come to  
27 the conclusion that this is perhaps too narrow a view  
28 and as it may be that they will seek the approval  
29 of the Treasury Board for such an investment, subject  
30 to limitations, the Treasury Board might find it







1 helpful to have the views of the Royal Commission on  
2 Banking and Finance on this subject in view of its  
3 intensive study of the banking system.

4 The reasons entertained in years gone by  
5 for not investing part of the resources of the Pension  
6 Fund in bank shares were principally twofold: one,  
7 that in the event of difficulties in the affairs of  
8 the bank, the interests of the members of the pension  
9 fund might be prejudiced and, two, that the acquisition  
10 of a large holding of shares in a bank may give the  
11 Pension Fund Trustees an unduly large role at  
12 shareholders meetings.

13 In my opinion the growth in strength and  
14 stability of the banks has caused the first reason  
15 to lose validity and the imposition of normal  
16 limitations on the proportion of the assets of the  
17 Pension Fund which may be invested in bank shares  
18 would cause the second reason to disappear. Moreover,  
19 it would be feasible and I think desirable to provide  
20 for voting of the bank shares by individual members  
21 of the Pension Fund in relation to their relative  
22 contributions to the Fund.

23 Our own Pension Fund would not propose to  
24 seek approval of a plan which would involve investing  
25 in the shares of competing banks nor would the  
26 trustees think it appropriate to invest more than  
27 a moderate part of the resources of the Fund in the  
28 shares of the bank whose employees it serves which  
29 we understand is customarily sanctioned. Even a  
30 modest limit would not be reached for many years





1 because the yield on the shares at the current market  
2 is considerably lower than the average yield available  
3 in other forms of investment. The objective would be  
4 to gain a gradual enhancement in value as the nation  
5 grows and bank services expand. In addition the  
6 investment would afford another means for the  
7 identification of the interests of bank officers with  
8 the progress of the institution.

9 It is, of course, a matter of common knowledge  
10 that the investment advisors and trustees of other  
11 pension funds regard bank shares as one of the most  
12 desirable forms of investment.



# Royal Commission on Banking and Finance

INSPECTION GENERAL OF BANKS.

Hearings  
held at

OTTAWA

Vol.

64

Date.

January 22, 1903.



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Toronto, Ont.





ROYAL COMMISSION ON BANKING  
AND FINANCE

- - - - -

Hearings held at Ottawa,  
Ontario, on Monday,  
January 21, 1963.

- - - - -

THE COMMISSION

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Chief Justice of Ontario  
Toronto, Ontario - Chairman

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Vancouver, British Columbia

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Vice-Chancellor  
Queen's University  
Kingston, Ontario

- - - - -

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary





Ottawa, Ontario,  
Monday,  
January 21, 1963.

--- At 9.15 A.M. the hearing resumed.

SUBMISSION OF

INSPECTOR GENERAL OF BANKS

- - - - -

APPEARANCES

C. F. Elderkin - Inspector General

- - - - -

THE CHAIRMAN: I call the meeting to order.  
This morning we have Mr. C. F. Elderkin, Inspector  
General of Banks.

Mr. Elderkin, we have read your submission.  
Do you wish to make an opening statement before  
we proceed to question you?

MR. ELDERKIN: No, Mr. Chairman. I  
have nothing to add to my submission.

THE CHAIRMAN: Then we will proceed with  
the discussion.

COMMISSIONER MACKINTOSH: Mr. Chairman,  
I suggest we start at the beginning and ask Mr.  
Elderkin some questions about the incorporation of  
banks and provision for them.

Is there anything in our experience of  
the last few decades that indicates that the require-





1       ments for incorporation as embodied in the Act in  
2       themselves represent any substantial barriers to the  
3       establishment of new banks?

4               MR. ELDERKIN: Dr. Mackintosh, this is  
5       a question that is difficult to answer with any  
6       degree of assurance. We have had some inquiries  
7       from time to time from Canadians, for the most part  
8       by letter, and we have given them the necessary  
9       information. In no case that I can remember has  
10      there been any follow-up on their inquiry. So,  
11      we are quite unaware as to whether the statutory  
12      limitations in the Act have an effect on their  
13      final decision or not.

14              We have had some other inquiries from  
15      overseas, from two banks, one of which, as you know,  
16      eventually resulted in the incorporation of the  
17      Mercantile Bank of Canada, 1953. Others who made  
18      inquiries decided after quite extensive investigation,  
19      that they could carry on business in Canada through  
20      a subsidiary with a different name, not including  
21      the word "bank". Apparently they are not interested  
22      in establishing a national bank set-up, but rather  
23      in conducting an investment agency business, deriving  
24      most of their funds from overseas.

25              So, it is rather difficult to state  
26      whether there was a statutory limitation which  
27      inhibited them from proceeding, or whether they  
28      felt that all the costs and expenses which they  
29      would have to meet in establishing a bank caused  
30      them to decide that they would be better off to con-





1 duct business in another manner.

2 COMMISSIONER MACKINTOSH: You mention  
3 in your brief that in the United Kingdom and in at  
4 least some parts of the United States there is no  
5 minimum capital requirement, whereas in Canada it  
6 is \$500,000. Is there any indication that this  
7 in itself is a barrier?

8 MR. ELDERKIN: Again, I cannot answer  
9 with any assurance. I have never known of any  
10 inquiries that resulted in an interview where the  
11 capital requirement has been an obstacle in any  
12 way. In fact, most of the foreign banks who  
13 have established subsidiary corporations in this  
14 country have put in far more capital than the  
15 minimum required in the Bank Act. As far as  
16 establishing any kind of national banking system  
17 in Canada, with any number of branches to speak of,  
18 the capital requirements are none too restrictive,  
19 as far as that is concerned.

20 COMMISSIONER MACKINTOSH: I infer you  
21 are inclined to say that if they were going to  
22 establish any kind of branch system, the practical  
23 minimum for capital requirement would be probably  
24 considerably above the statutory requirement?

5 MR. ELDERKIN: Yes, I would definitely  
6 say so, because I think you have before you in  
7 evidence that the established banks consider that  
8 it takes three to five years to make a branch pay,  
9 and that they have their profits from the other  
10 branches to offset that loss. I believe a completely





1 new bank would still go through a period of from three  
2 to five years, if not more, before becoming a  
3 profitable operation, and with no offsetting  
4 profits. The new bank is most certainly likely  
5 to face a deficit period, the size of which would  
6 depend on how quickly it branched out.

7 That is the reason why, in discussing  
8 this question with people who appeared to have a  
9 serious intention, we have suggested to them that  
10 we certainly would not like to see these losses,  
11 which are inevitable, impair their paid-up capital,  
12 and that we would certainly like to see them place  
13 some additional capital either in their rest account  
14 or in their inner position to take care of the first  
15 few years of operational loss.

16 COMMISSIONER MACKINTOSH: The establishment  
17 or incorporation of a bank, I understand, requires  
18 the approval of the Treasury Board. Is that right?

19 MR. ELDERKIN: No. The licence to do  
20 business after incorporation requires approval of  
21 the Treasury Board. Prior to that the normal pro-  
22 cedure -- and we have had only two experiences in  
23 the last thirty-two or thirty-three years -- is to  
24 get the informal approval of the Minister of Finance  
before seeking a bill. This has been given in the  
two cases that have gone forward.

25 COMMISSIONER MACKINTOSH: Is he concerned  
with other than statutory requirements?

26 MR. ELDERKIN: I mentioned one a minute  
ago - that is, additional reserves, either inside or







1 outside, to provide for what might be called organ-  
2 ization losses. He is certainly interested in the  
3 status of the people who are making application.  
4 One you might call moral; the other is financial.  
5 If the bank should run into more than the ordinary  
6 losses that might occur, the Minister would want to  
7 know if the sponsors are in a position to provide  
8 further capital. I think these are the two main  
9 non-statutory things that he would look at.

10 COMMISSIONER MACKINTOSH: Have there been  
11 inquiries which came to your notice from American  
12 banks?

13 MR. ELDERKIN: No formal inquiries, Dr.  
14 Mackintosh. I think the American banks are so  
15 aware of our whole banking law and of the possibilities  
16 in Canadian banking, that they probably have made  
17 any decisions they have come to without making any  
18 formal inquiries. It has never been my experience  
19 that we have had a formal inquiry from an American  
20 bank.

1 We have had two or three occasions on  
2 which representatives of American banks have  
3 discussed the subject, not so much from an intention  
4 to incorporate, but simply to obtain further informa-  
5 tion.

6 COMMISSIONER MACKINTOSH: To what extent,  
7 if any, do you think the period of initial losses,  
8 which seems discouragingly long from the point of  
9 view of any corporation contemplating a bank in  
10 Canada, would result from the 6 per cent ceiling and





1 the prohibition of doing mortgage business, other  
2 than insured mortgages?

3 MR. ELDERKIN: It would undoubtedly have  
4 an effect to some extent, Dr. Mackintosh, but if  
5 these two prohibitions were out of the Act a new  
6 bank would face just as much competition from the  
7 already established banks who would have the same  
8 privileges.

9 I might say that one of the great impedi-  
10 ments to a bank starting is the difficulty in  
11 obtaining competent staff trained in Canadian banking.  
12 In the two new banks we have had start in this  
13 century, one of the large factors involved in

14 the early loss operation, has been the difficulty  
15 in obtaining competent staff. This is particularly  
16 so in regard to loss experience on loans, where  
17 inexperienced officers can certainly get a bank  
18 into trouble very quickly.

19 COMMISSIONER MACKINTOSH: I would think  
20 the limitations which are referred to would also  
21 restrict the prospects of a new bank from starting  
22 as it were in a specialized area and gradually  
23 undertaking general banking business.

24 MR. ELDERKIN: I think that is very true,  
25 Dr. Mackintosh. In the case of European banks,  
26 who are not used to these restrictions, this could  
27 be considered quite an impediment from their point  
28 of view.

29 COMMISSIONER MACKINTOSH: It appears  
30 obvious that to set up a banking system with branches







1 coast to coast, and set it up in a fairly short  
2 period of time, is quite a formidable objective for  
3 any corporation. What seemed to be the considerations  
4 which have led to there being virtually no agencies  
5 or subsidiaries of United States banks, whereas our  
6 banks have their agencies and subsidiaries abroad?  
7 This arrangement does not seem to be reciprocal.

8 MR. ELDERKIN: If you are speaking entirely  
9 of United States banks, our Canadian banks operate  
10 through subsidiaries and agencies in California,  
11 Oregon and Washington, and through agencies only  
12 in New York. In the case of New York and California,  
13 the agencies are prohibited from taking deposits  
14 from state residents, and the agencies do not  
15 conduct a chequing business, although they come  
16 very close to it because they will accept drafts.  
17 It is not normally what we call a chequing business.

18 Two banks have subsidiary corporations  
19 based in California, but our national banks there  
20 come under all national bank rules. They are  
21 incorporated as such. I might add at this stage  
22 that two banks have incorporated subsidiaries in  
23 France, and come under the French banking law. I  
24 can only say that the thinking behind it is that  
25 any organization in Canada that uses the word "bank"  
26 should come under the banking law of the country,  
and there should be no differences in the privileges  
to these organizations, unless they are under  
separate banking laws.

May I add one more point? As I mentioned





1 earlier, you have subsidiaries of foreign banks  
2 doing business in this country in practically every  
3 way except in taking deposits and operating chequing  
4 accounts, but by law they are not allowed to use  
5 their parent name where it includes the word "bank".  
6 We have one subsidiary, as you may be aware, which  
7 is that of a bank which does not have the word "bank"  
8 in its name. I refer to the "Credit Suisse" and  
9 it operates here under that name.

10 COMMISSIONER LEMAN: They are allowed  
11 to use the name where it does not contain the word  
12 "bank", but are they not allowed to put under their  
13 name the fact that they are a subsidiary of or  
14 affiliated with such and such a bank?

15 MR. ELDERKIN: They do, Mr. Lemman.  
16 I think both of the Swiss banks represented here put  
17 on their letterhead and on the advertising the fact  
18 that they are affiliates of certain banks, and they  
19 give the parent name.

20 COMMISSIONER MACKINTOSH: We have no  
21 provision in our law for designating a firm as  
22 a partial bank and not a whole bank?

23 MR. ELDERKIN: No.

24 COMMISSIONER MACKINTOSH: Do you know  
25 of the section which requires the majority of any  
26 bank board to be composed of British subjects?

MR. ELDERKIN: Yes.

COMMISSIONER MACKINTOSH: Does that act  
as an obstacle at all?

MR. ELDERKIN: No.





1 COMMISSIONER MACKINTOSH: There are ample  
2 applicants for bank directorships?

3 MR. ELDERKIN: I don't think this could  
4 have very much influence anyway, because a foreign  
5 bank could very easily have Canadian representatives  
6 acting on its board of directors. I don't think  
7 this has been any obstacle whatsoever.

8 COMMISSIONER MACKINTOSH: What kind of  
9 operation does an agency or subsidiary of a foreign  
10 bank carry on?

11 MR. ELDERKIN: Mostly investment business,  
12 and in some cases I think some mortgage lending.  
13 I think they derive their funds entirely from  
14 European sources or from their parent bank.

15 COMMISSIONER MACKINTOSH: How much staff  
16 do they require? Are they a small operation?

17 MR. ELDERKIN: Yes, comparatively small.  
18 They do take equity positions in Canadian corporations;  
19 they do make term loans, and in some cases they do  
20 invest in Canadian term securities as well.

21 COMMISSIONER MACKINTOSH: So that really  
22 out of what we have been discussing there comes  
23 one positive change, whether it is desirable or  
24 not, which might make a difference in the ease of  
25 entry, <sup>which</sup> is the enlargement of the bank scope through  
26 admitting mortgage lending, for instance?

27 MR. ELDERKIN: I would think so.

28 COMMISSIONER MACKINTOSH: What might  
29 be thought of as the other side of the picture would  
30 be to some extent the disappearance of banks through







1 merger. This is something which requires the approval  
2 of the Treasury Board, does it not?

3 MR. ELDERKIN: It requires the approval  
4 of the Minister first before the shareholders can  
5 be approached to vote for a merger. He may block  
6 it at that time if he sees fit by refusing to give  
7 permission to approach the shareholders. If the  
8 shareholders approve of a merger, it requires the  
9 approval of the Governor in Council on recommendation  
10 of the Treasury Board; and when the Governor in  
11 Council approves it, an order in council has then  
12 the force of law.





1 COMMISSIONER MACKINTOSH: Are there any  
2 criteria laid down in the Act for the Minister and the  
3 Treasury Board?

4 MR. ELDERKIN: None whatsoever, Dr. Mackintosh.  
5 It is solely a matter of opinion at this stage -- well,  
6 it is a matter of opinion at all stages. The Act  
7 specifically states that the Treasury Board may refuse  
8 to recommend without reason, and the Governor in Council  
9 may refuse to approve without reason.

10 COMMISSIONER MACKINTOSH: I suppose that means  
11 without stating reasons.

12 MR. ELDERKIN: Yes, you are quite right.

13 COMMISSIONER MACKINTOSH: Without referring,  
14 of course, to any specific cases, are you in a position  
15 to indicate some of these sorts of considerations that  
16 enter into this?

17 MR. ELDERKIN: I think there are two or three.  
18 The first one that is given consideration by the  
19 Minister is whether it will eliminate or diminish  
20 greatly the competition in very many communities in the  
21 country. You may remember after the last merger  
22 Canadian  
23 between the Bank of Commerce and the Imperial Bank of  
24 Canada, that those two banks stated that they had no  
25 intention of closing any branches in the country within,  
26 at least, the next two years. This is one factor that  
27 is very definitely given consideration at the time.

28 Another factor is the question of whether  
29 the combined or amalgamated bank can provide better  
30 competition and a better service. I can recall that at  
31 the time of the merger of the Bank of Toronto and the







1 Dominion Bank one of the reasons advanced was that both  
2 banks had heavy concentration in the province of Ontario,  
3 and that they did not require many more branches in  
4 order to service Ontario and, therefore, their expansion  
5 could take place in other provinces more quickly if they  
6 were one unit.

7 These are, I think, the principal reasons  
8 that might influence the Minister in making his decision,  
9 and the Governor in Council also.

10 COMMISSIONER MACKINTOSH: I think, without  
11 being too ingenious, I could have reversed the argument  
12 you have made.

13 MR. ELDERKIN: I am not making an argument  
14 at all, Dr. Mackintosh.

15 COMMISSIONER MACKINTOSH: No, you are only  
16 repeating it. I think that is all I have to ask.  
17 Perhaps some other members of the Commission wish to  
18 pursue this subject further.

19 COMMISSIONER BROWN: I would like to have  
20 clarification in my mind about your reference to a  
21 national banking system and the problems of establishing  
22 a new one. Is this because in practice it is not  
23 feasible to operate a bank without having a national  
24 system, or is this one of the unstated conditions?

25 MR. ELDERKIN: No, it is not one of the  
26 unstated conditions at all. I do not recall that we  
27 ever suggested to any inquirer that they must have a  
28 branch system across Canada. It has been pointed out  
29 to them that they are in a rather poor competitive  
30 position without a branch system across Canada.





1 It is quite feasible, Mr. Brown, that a bank  
2 could start in Canada and carry on with only one branch  
3 for a while until it got into a profitable position.  
4 To do so it would be very restricted in the amount and  
5 the size of the loans it made, and probably it would have  
6 to devote quite a bit of its business to the security  
7 end rather than the commercial loaning end. The result  
8 is that it would take some time even then to get into  
9 a profitable position.

10 It could open another branch in another  
11 community, perhaps, and so over a great many years it  
12 could build up a branch banking system in that way, but  
13 this would mean that any hope of ultimate profits, or  
14 of a profitable operation for that bank as a whole,  
15 would be many, many years away.

16 COMMISSIONER BROWN: The other thing that  
17 you referred to was the subsidiary of the Swiss Bank,  
18 and certain other subsidiaries of foreign banks. You,  
19 apparently, know what they are doing and how they are  
20 operating.

1 MR. ELDERKIN: By hearsay.

2 COMMISSIONER BROWN: I was going to ask you  
3 if they were subject to any jurisdiction at all? Do  
4 they report to anybody?

5 MR. ELDERKIN: Not that I know of.

6 COMMISSIONER BROWN: They just operate as  
7 an ordinary corporation with no reports at all?

8 MR. ELDERKIN: Outside of the ones required  
9 by the Secretary of State, if they are a federally  
10 incorporated company, or by the Provincial Secretary if





1 they are provincially incorporated.

2 COMMISSIONER BROWN: Do any of these take  
3 deposits and operate chequing accounts?

4 MR. ELDERKIN: Not that I know of, no.

5 COMMISSIONER LEMAN: You mentioned, Mr.  
6 Elderkin, that one of the problems, at any rate, is that  
7 of finding trained and competent personnel to run a  
8 banking business.

9 MR. ELDERKIN: Yes.

10 COMMISSIONER LEMAN: And one could imagine  
11 that if a strong group, having access to capital  
12 resources sufficient to start a bank, did start one  
13 they might be able to attract away from the existing  
14 banks some trained personnel, but, generally, what  
15 have you found to be the pattern? Is there any movement  
16 of senior personnel from one bank to another, or has  
17 that been extremely limited?

18 MR. ELDERKIN: Very limited, Mr. Leman. The  
19 trained personnel of the only new bank that we have have  
20 all come, almost entirely, from bankers who had left  
21 other banks to go into another type of business at some  
22 earlier date and who were employed by the new bank.  
23 Even these are not easy to get sometimes because they  
24 may be in a business which shows far better prospects  
25 for them than the new bank. As you say, if there was  
26 sufficient capital and the sponsors were prepared to  
27 wait for a good many years before getting any return on  
28 that capital they could, without doubt, afford to make  
29 some very attractive offers for personnel, but there  
30 has been very little movement between banks during my







1 tenure of office.

2 COMMISSIONER BROWN: I would like to ask,  
3 Mr. Elderkin, whether there has in the past been any  
4 discussion at any time about limiting the size of  
5 bank boards. There is a minimum required by the Act  
6 of five, but there is no maximum. Has this ever been  
7 discussed?

8 MR. ELDERKIN: Never to my knowledge. Never  
9 from the official side has there been any suggestion  
10 that it should be limited.

11 COMMISSIONER BROWN: Has there been any  
12 discussion about prohibiting interlocking directorates  
13 as between banks and other institutions?

14 MR. ELDERKIN: There has been a fair amount  
15 of discussion in the Banking and Commerce Committee  
16 from time to time on this, but there has never been any  
17 prohibition.

18 COMMISSIONER BROWN: Do you remember the pros  
19 and cons that have been put up about this?

20 MR. ELDERKIN: Well, I think one of the cons  
21 with respect to this is that it might be placing too  
22 much financial control of the country in a very few  
23 hands, but to what extent this is a logical argument  
24 is, of course, open to debate.

25 One of the pros, of course, from the banks'  
26 side, is that it does make available to them men who  
27 have substantial training in business, and the advice  
28 of whom is very valuable to the banks.

29 COMMISSIONER BROWN: Do you think that the  
30 size of bank boards has acted as an inhibition at all





1 against new banks getting started -- in order words,  
2 the difficulty of attracting directors who have had  
3 experience in other banks?

4 MR. ELDERKIN: Who have had experience in  
5 other banks?

6 COMMISSIONER BROWN: Yes, as directors. In  
7 other words, what I am trying to say is: Have all the  
8 present banks got all the eligible directors so that a  
9 new bank could not get any?

10 MR. ELDERKIN: I hope not, Mr. Brown. That  
11 would hurt some people's feelings very badly.

12 COMMISSIONER MACKINTOSH: Do you think there  
13 would be less difficulty in transferring directors as  
14 between banks than officers?

15 MR. ELDERKIN: It has occurred on one  
16 occasion, Dr. Mackintosh.

17 COMMISSIONER BROWN: Now, there are inter-  
18 locking directorates as between banks and other  
19 financial institutions some of which fall into the  
20 category that has been frequently described before this  
21 Commission as that of near-banks. If the whole banking  
22 system were widened so that the banks as such were able  
23 to compete more effectively with the near-banks, and  
24 similarly if the near-banks were placed in a position  
25 of being able to compete more effectively with the banks,  
26 would you see these interlocking directorates at that  
stage providing some problems?

MR. ELDERKIN: I know a great many who  
object to this word "interlocking".

COMMISSIONER MACKINTOSH: They do not like







1 the expression "common directors" either.

2 MR. ELDERKIN: No. Well, this, of course,  
3 simply comes down to a question of how the directors  
4 act; whether in their respective capacities they act  
5 for the benefit of the institution they are serving at  
6 the time, or whether they are trying to act for the  
7 benefit of the other institution in which they are  
8 interested. If they can divorce their reasoning on  
9 this, and if they can keep separate the business of the  
10 two, there can be very little harm done, but naturally  
11 if one tries to influence both businesses for the sake  
12 of one then there can be harm.

13 COMMISSIONER BROWN: Let us put it this way;  
14 have you known of any cases where one person has been on  
15 the board of two banks at the same time?

16 MR. ELDERKIN: No. As a matter of fact, I  
17 think without exception the banks' own bylaws prevent this.

18 COMMISSIONER BROWN: Just to get it on the  
19 record could you outline for us the various reports you  
20 get with respect to loans to directors and loans to  
21 corporations which are represented by directors on the  
22 boards of banks?

3 MR. ELDERKIN: Well, we get a monthly  
4 statement of loans to directors and to firms of which  
5 they are members -- not to corporations. The others  
6 are examined at a certain level at the time of the  
7 annual inspection. That is, in the course of my  
8 inspection we request the banks to submit reports of  
9 individual loans over a certain minimum, the minimum  
10 depending upon the size of the bank. This ranges from





1 quite a small amount in respect to a small bank to a  
2 substantial amount in respect to a large bank.

3 These individual reports would include all  
4 those over that minimum to directors and to corporations  
5 in which they are interested, but not those below unless  
6 they were in an unsatisfactory condition in which case  
7 we ask again for reports of any loan down to a comparat-  
8 tively small amount.

9 COMMISSIONER BROWN: Are you free to give us  
10 some idea of how this level is determined?

11 MR. ELDERKIN: Yes, surely. We start off  
12 with about one per cent of the capital and rest which,  
13 in the case of the smallest bank, would be \$50,000.  
14 We never go above \$1 million as a minimum.

15 COMMISSIONER BROWN: In other words, it is  
16 either above a million or one per cent of the capital  
17 and rest, whichever is the lesser.

18 MR. ELDERKIN: Yes. It might be even less  
19 than that in the case of the intermediate banks.

20 COMMISSIONER LEMAN: Before you leave that  
21 point, Mr. Brown, may I ask Mr. Elderkin what he does  
22 with these reports.

23 MR. ELDERKIN: The reports are quite  
24 comprehensive, Mr. Leman. They give the amount of each  
25 individual type of loan which the borrower has at that  
26 time, which is at a selected date in each year. They  
27 give the security which the bank holds in respect of  
28 those loans. They give the latest balance sheet which  
29 the bank has on file, and a summary of the latest  
30 profit and loss statement which the bank has on file.





1 Then, in addition to this the bank is requested at the  
2 time to give a brief summary of remarks regarding the  
3 status of the loan, whether it is operating satisfac-  
4 torily or not, and if not, why?

5 Now, out of these -- which amounted to  
6 something over 3,600 reports last year -- we select  
7 any that show any sign of being in an unsatisfactory  
8 position, and at the time of the inspection at the head  
9 office we draw all of the files with respect of those  
10 loans and examine them further to see if there is any  
11 information which has not been given to us and which  
12 can be of value in assessing the loan.

13 COMMISSIONER BROWN: And you discuss them  
14 with the bank's senior officers who authorized the  
15 credit?

16 MR. ELDERKIN: Yes, and with the auditors  
17 in some cases as well, which we have the power to do  
18 under the Act. Anything that appears to be in an  
19 unsatisfactory condition is normally discussed with  
20 the credit officers, and later with the general manager.

1 COMMISSIONER BROWN: Can you tell us what the  
2 total figure was for all these reports last year?

3 MR. ELDERKIN: Yes, I think I mentioned that  
4 in my submission.

5 COMMISSIONER BROWN: Is it in paragraph 32?

6 MR. ELDERKIN: Yes, it is in paragraph 32:

7 "In 1961 more than 3,600 of these reports  
8 covering aggregate outstanding loans of  
9 over \$4,200 million were received from the  
10 banks."







1 COMMISSIONER BROWN: And these are the reports  
2 of which you have been speaking?

3 MR. ELDERKIN: Yes, these are the reports of  
4 which I have been speaking.

5 COMMISSIONER BROWN: Turning now to the  
6 capitalization of banks I wonder if you would outline  
7 for us the reason why they all have the same fixed  
8 par value of \$10 a share?

9 MR. ELDERKIN: Well, we go back into history  
10 for this to a certain extent. At one time all bank  
11 shares had a par value of \$100. Later, in 1944, I  
12 think I am right in saying, they were split into shares  
13 of \$10 par value each. You can find nothing in those  
14 proceedings which indicates the reason for the par value  
15 of \$100. It is supposed by some people that the purpose  
16 of the legislation was to restrict ownership to those  
17 who were quite financially responsible because the  
18 legislation at that time attached a double liability to  
19 the banks' shares.





1 That is the only reason I can think  
2 of for the \$100 par value at that time. As far  
3 as the general principle of par value is concerned,  
4 I do not know that I can offer you anything on this.  
5 In Great Britain par value is often one pound per  
6 share. In the United States the par value varies  
7 according to the articles of incorporation. I know  
8 that one large bank in New York has a par value of  
9 \$6.25, another one a par value of \$12.50, and  
10 still another one \$25. There is no uniformity  
11 in the par there as far as I know.

12 COMMISSIONER MacKEEN: The par  
13 value was necessary as long as the double liability  
14 was there. Now that that has been removed is there  
15 any longer a necessity?

16 MR. ELDERKIN: There is some advantage  
17 from the statistical point of view, but that is  
18 not too important. Of necessity, no.

19 COMMISSIONER BROWN: There is another  
20 reference in the Act to limitation on dividends until  
21 the rest fund is equivalent to 30 per cent of the  
22 par value.

23 MR. ELDERKIN: Yes. That would have  
24 to be changed, but that would simply be changed to  
25 30 per cent of the paid-up capital, I suppose.

26 COMMISSIONER BROWN: Yes.

27 THE CHAIRMAN: Is there a sort of  
28 mystique attached to the par value?

29 MR. ELDERKIN: Quite a bit of our  
30 banking law originally came from Scotland and England,







1 and they have not even allowed par value on ordinary  
2 corporations over there unless it has been quite  
3 recent -- I should say no par value, I beg your  
4 pardon.

5 COMMISSIONER MacKEEN: If the old  
6 \$100 par value had been retained the shares held  
7 would have theoretically at least a market value  
8 of ten times what they are today.

9 MR. ELDERKIN: Yes. In most banks it  
10 would be up in the range today of \$6,000 or \$7,000.

11 COMMISSIONER MacKEEN: That would  
12 mean there would be very substantially fewer share-  
13 holders.

14 COMMISSIONER MACKINTOSH: I think you  
15 mean in the range of \$600 to \$700.

16 MR. ELDERKIN: Yes, \$600. I beg  
17 your pardon.

18 COMMISSIONER MACKINTOSH: I noticed  
19 that some of the audience were feeling richer than  
20 they actually are.

21 MR. ELDERKIN: Yes. I would not want  
22 to raise their hopes, Dr. Mackintosh. Well, this  
23 was actually the object in the revision, to change  
24 the par down to \$10 to get a wider distribution of  
25 shares. I think this can be considered to have been  
26 a very successful operation.

COMMISSIONER MacKEEN: If the market  
value has been enhanced since the reduction to the  
\$10 par, would you consider it desirable to remove  
that \$10 par restriction to give even wider distribution?





1 MR. ELDERKIN: I am afraid you are getting  
2 me very close to government policy, Mr. MacKeen,  
3 and I would not want to put myself on record in  
4 this regard. It might be interesting to the  
5 Commission for me to interject at this point that  
6 at the end of the fiscal year 1961, 84.1 per cent  
7 of shareholders and 75.6 of the shares were registered  
8 in Canada, and that almost 93 per cent of the holdings  
9 were under 500 shares. This, I think, is a direct  
10 result of the reduction from \$100 to the \$10 par  
11 value.

12 There is another point here that  
13 subject to section 36, which has some restrictions,  
14 it has been much easier to issue new shares to the  
15 public because of the lower per share value.

16 COMMISSIONER LEMAN: Without getting  
17 into government policy, are you prepared to state  
18 that it would not be desirable to work them down  
19 into penny stocks?

20 MR. ELDERKIN: Well, you might take  
21 some of the prestige out of it, Mr. Leman.

22 COMMISSIONER BROWN: You refer to  
23 the issuance of new shares. The price of these  
24 is now limited to the balance sheet value of the  
25 stock.

26 MR. ELDERKIN: Yes.

27 COMMISSIONER BROWN: What is the  
28 historical background of this?

29 MR. ELDERKIN: As I mentioned a while  
30 ago, when there was a double liability on the shares





1 it was considered desirable by the bank, and presumably  
2 by the government, to have these in the hands of  
3 financially responsible people, that is, people  
4 who could respond to a call for double liability.  
5 I would say that that requirement is antiquated  
6 or archaic.

7 COMMISSIONER BROWN: Do you see some  
8 virtue in establishing this at a minimum rather  
9 than as a "price at which"?

10 MR. ELDERKIN: This is now the maximum  
11 at which they can be issued. I do not think  
12 establishing that price, that this as  
13 a minimum would have any great effect myself, for  
14 I think it is quite normal that the shares could  
15 be sold at a higher price than the balance sheet  
16 value.

17 COMMISSIONER MacKEEN: It does tend  
18 to make for fairly expensive money as far as the  
19 banks are concerned on new issues.

20 MR. ELDERKIN: Very expensive money,  
21 and very nice for the shareholders in the sale  
22 of rights or in picking up new stock at a comparatively  
23 low price.

24 COMMISSIONER MacKEEN: Might it have  
25 the effect of delaying issues on the part of  
26 management on account of the cost of money?

27 MR. ELDERKIN: Well, one would think  
28 so, Mr. MacKeen, although one can only say there  
29 have been a great number of new issues in the past  
30 eight years. What delayed issues prior to that time







1 was not so much the cost of money as the requirement  
2 in the Act that these shares must be offered to all  
3 shareholders at the time. This meant that they  
4 must be offered in the United States where it was  
5 illegal to make an offering except if it was approved  
6 by the S.E.C..

7 In 1954 the Act was changed, as you  
8 may remember, to the effect that the banks did not  
9 have to make this offer to shareholders in any  
10 country which demanded more information than that  
11 which was published by statute in Canada. The  
12 practice now is not to offer shares in the United  
13 States. I do not consider there are any inhibitions  
14 otherwise and the shareholders in the United  
15 States get transferable rights. They cannot  
16 exercise them themselves, of course, but they can  
17 sell them.

18 COMMISSIONER BROWN: There is an  
19 indirect prohibition on the pension funds of banks  
20 owning any bank shares, and there has been a  
21 suggestion made to us that this might be eased.  
22 Would you see any problems arising if this were  
23 permitted?

24 MR. ELDERKIN: That prohibition arose  
25 from some abuses of pension funds in the past. I  
26 think it is on record that at least one bank, which  
27 is now defunct, used the pension fund to sustain  
28 the market for some time and practically ruined  
29 the pension fund. There have been some cases in  
30 corporations where the same abuse has taken place.





1  
2 If a bank were permitted to contribute to a pension  
3 fund which invested in the stock of the bank, I  
4 would think some limitation should be placed on the  
5 amount of stock that the pension fund could hold in  
6 proportion to its other assets. In other words,  
7 the pension fund should not be in a free position  
8 if the trustee saw fit to accumulate a lot of the  
9 bank stock. This could be abused under certain  
10 circumstances. I do not say it would be; I simply  
11 say it could be.

12  
13 COMMISSIONER BROWN: How about the  
14 shares of other banks?

15 MR. ELDERKIN: I do not think this  
16 would ever be permitted, for this has always been  
17 a rule that banks may not acquire the shares of  
18 other banks. I would doubt that the government  
19 would see fit to allow the pension fund of a bank  
20 to do this because it would be allowing some-  
21 thing to be done indirectly that was not allowed to  
22 be done directly.

23  
24 COMMISSIONER BROWN: As I understand it  
25 there is a prohibition against a bank investing  
26 in the common shares of competitors but no pro-  
27 hibition against it investing the shares of near  
28 banks, that is, near competitors. Do you see  
29 anything different there?







1 MR. ELDERKIN: Yes, I think there  
2 is a slightly different viewpoint. So far as  
3 I know this has always been a provision in the Bank  
4 Act, that a bank may not own these<sup>bank</sup>/shares unless,  
5 of course, it is in the process of taking over  
6 another bank, which it does under government  
7 authorization.

8 COMMISSIONER BROWN: This would  
9 mean that if the near banks got stepped up to the  
10 category of banks there would be some changes that  
11 would have to be made?

12 MR. ELDERKIN: That is right. If  
13 they came under the Bank Act, then the original  
14 holder of the shares would have to get rid of  
15 them.

16 COMMISSIONER BROWN: I would like  
17 to have a short discussion about inner reserves,  
18 without producing any information which is otherwise  
19 not available. Perhaps you would outline for us  
20 what the situation is in the United States.

21 MR. ELDERKIN: In 1947 the banks,  
22 after a great many years, succeeded in --

23 COMMISSIONER BROWN: Excuse me.  
24 Perhaps we could go back a little bit first before  
25 getting into this.

26 MR. ELDERKIN: Yes.

27 COMMISSIONER BROWN: Would you for  
28 the record give us a short summary of the history  
29 of the development of inner reserves in Canada?

30 MR. ELDERKIN: Yes. The object, of





1 course, of inner reserves is to meet losses which may  
2 occur in a year where the available earnings are not  
3 sufficient to cover them. It has always been a prin-  
4 ciple in Canadian income tax law to permit inner  
5 reserves, some by statute in particular cases. For  
6 instance, the trust companies have a general loss  
7 reserve of 3 per cent on mortgages. Up until 1944  
8 there was no general formula or uniform treatment  
9 of inner reserves in the banks.

10 During the hearings of the Banking  
11 and Commerce Committee in 1944 an amendment was  
12 proposed and later passed to charge the Minister of  
13 Finance with the responsibility of establishing  
14 uniformity in inner reserves of the banks to the  
15 extent that they were permitted to set up such inner  
16 reserves out of taxable profits.

17 This amendment, as I mentioned, came  
18 from the Committee, and not as an original proposal  
19 in the amendments to the Act of that year. So, no  
20 advance preparation had been made for it. When it  
21 came to working out a formula it was rather difficult  
22 to get accurate information for a background, for  
23 the accounting methods used by the banks not only for  
24 income and expenditure but also for loss treatment  
25 were not uniform and had not been uniform in the past.  
26 However, a reserve formula was put together at that  
27 time, and applied to all fiscal years in 1943 and  
28 thereafter.

29 Between that time and 1947 we made  
30 an effort to establish uniform records in so far as





1 that was possible, and in 1947 there was a revision  
2 to some extent in the formula, dropping out of it  
3 a provision which related to the particular loss  
4 experience of the individual banks. The formula  
5 then became applicable to all banks on the same  
6 percentage basis. This carried through pretty well  
7 until 1954, subject from time to time<sup>to</sup>/eliminating  
8 from the base certain types of assets such as  
9 government guaranteed loans and bank guaranteed  
10 letters of credit, corporate stocks, and such things  
11 as we felt should not come under the particular  
12 reserves.

13 This formula was then tabled in  
14 1954, and established at that time in general 2 per  
15 cent on Government of Canada bonds, 3 per cent on  
16 provincial bonds, 5 per cent on other securities,  
17 5 per cent on specified loans, and 5 per cent on  
18 long foreign exchange positions.

19 I should like to interject here that  
20 to a considerable extent the reserves permitted  
21 against bonds of Canada and the provinces was meant  
22 to be a valuation reserve. The Act then called  
23 for these bonds to be stated in all financial  
24 statements of a bank at not more than the market  
25 value. Few further changes were made to 1957.  
26 In December 1956 the Bank of Canada, with the  
27 approval of the government, and its own auditors,  
28 decided that they would thereafter state Government  
29 of Canada bonds, and provincial if they had any, at  
30 amortized value rather than market value.







1 And upon doing so, turned over to the government  
2 Consolidated Revenue Fund an amount of about \$42 million,  
3 if I remember rightly, which they were holding in  
4 reserve on these bonds.

5 Following this action on their part, it was  
6 decided to take the same action in regard to the  
7 chartered banks, and it was done by Order-in-Council.

8 I might say that this has been a privilege,  
9 if you will, that insurance companies have had since,  
10 I think, 1950 or 1951, when their Act was changed to  
11 permit -- but not to require -- the insurance companies to  
12 report these bonds at their amortized value. Consider-  
13 ation was given to whether this should be permission  
14 or a requirement, and the government decided it should  
15 be a requirement in order that all banks should be  
16 reporting on a uniform basis. If it was permission only,  
17 it is probable that some banks would put reserves  
18 against these bonds while others maybe would not. In  
19 any case, the formula was changed and this released a  
20 substantial amount of specific and general reserves  
21 against these particular types of securities. This was  
22 the major change for some time.

23 I think the next change came at a later date;  
24 yes, in 1960, that was the date on which we introduced  
25 the present formula for determining the annual maximum  
26 reserve percentage. The method of calculation is  
27 explained in the note in the submission. At the same  
28 time, other changes in 1960 provided that all specific  
29 reserves on related assets were to be deducted from  
30 the maximum par and that any surplus reserve over par





1 at the end of the fiscal year was to be added to the  
2 fiscal profits of that year. That is the history of  
3 the formula that is in force today.

4 Now, to carry on, unless you wish to ask  
5 me questions on that. With regard to your first  
6 question, the United States first put the formula into  
7 effect in 1947, a matter of two or three years after  
8 we did, and they were apparently -- and still are,  
9 apparently -- prevented from having a general loss  
10 formula for all banks in the country because their  
11 Act specifically prohibits contingency reserves, and to  
12 permit the banks or to permit a ruling which would give  
13 the banks a uniform formula would require, I understand,  
14 an amendment to their Internal Revenue Code. They  
15 started off with a formula which gave to individual banks  
16 three times their <sup>average</sup> loss experience for the twenty years  
17 ending with the current year.

18 In 1957 I believe they changed this to any  
19 twenty consecutive years, because the banks pleaded that  
20 they were moving out of the twenty year period, out of  
21 the heavy loss experience.

22 The result of this is rather fantastic. You  
23 get individual banks in the United States which have  
24 a loss experience now of perhaps 2 per cent, and the one  
25 across the street may have a loss experience of 6 per cent.  
26 I am speaking of not the loss experience, but the  
27 permitted average, and this results from what happened  
28 some thirty to forty years ago and not from anything  
29 that the present management has had to do with at all.  
30 We rejected this idea, as I say, in 1947; we didn't







1 think this was an equitable arrangement, and we were  
2 able to reject it because the income tax law gave scope  
3 to that effect.

4 At the present time this matter in the States  
5 has been under review, and the recent report of the  
6 Comptroller of the Treasury, Mr. Saxon, recommends that  
7 the Act be amended and that a universal percentage be  
8 used for all banks in the country. This, as a matter  
9 of fact, has been the recommendation in, I think, every  
10 report of the Comptroller of the Currency that I have  
11 read in the past five or six years, because of the  
12 inequities that have arisen through the Act as it is  
13 today. To the best of my knowledge Canada and the  
14 United States are the only countries that do give  
15 generally bad debt reserves to the banks, and which  
16 may be created out of taxable profits.

17 COMMISSIONER BROWN: In the United States  
18 the calculation is in addition to the specifics?

19 MR. ELDERKIN: No, I am afraid that the  
20 gremlins got into my report, because in the original  
21 report I said in addition to specifics, because that  
22 was the information we had at the time, but later I  
23 checked through our Mission in Washington and they  
24 informed me that this is no longer the case, that the  
25 general reserves include any specifics, which is  
26 identical with ours in that respect.

27 COMMISSIONER BROWN: Have you by any chance  
28 made a comparison? By this I mean if you ran the  
29 American formula over the Canadian banks, how close  
30 would it agree?





1 MR. ELDERKIN: Are you asking as to  
2 individual banks or as to the system which we use on  
3 a national basis?

4 COMMISSIONER BROWN: On a national basis.

5 MR. ELDERKIN: Yes, it would be considerably  
6 lower in Canada, and this is quite understandable  
7 because the loss experience in Canada was probably  
8 lower than it was in the United States anyway, for one  
9 thing, during the 1930's and they are using an average  
10 which includes the 1930's. If we used the same average  
11 here for a twenty year period and ended in 1947, we  
12 would come up with a ratio of .572; if we used the  
13 average loss experience, or if we used --

14 COMMISSIONER BROWN: .572 for three years  
15 would be ---

16 MR. ELDERKIN: Or three times that.

17 COMMISSIONER BROWN: Three times that, which  
18 would be 1.716.

19 MR. ELDERKIN: However, the Internal Revenue  
20 Department in the States prepared another basis here  
21 in which they used an average of the annual loss ratios  
22 -- and this is rather a unique sort of calculation --  
23 rather than an average of the annual loss experience,  
24 and this would produce in Canada the higher figure --  
25 as it would there, of course -- which would amount to  
26 about .72.

27 COMMISSIONER BROWN: It would be about 2.16?

28 MR. ELDERKIN: Yes.

29 COMMISSIONER BROWN: Now, do I gather,  
30 then, that the par that was picked on for the Canadian





1 system was more or less taken out of the air?

2 MR. ELDERKIN: To start with?

3 COMMISSIONER BROWN: Yes.

4 MR. ELDERKIN: To a great extent, yes, but  
5 it was done after consultation with the banks and after  
6 consultation with bank auditors, and it took into  
7 consideration such heavy loss experience as had been  
8 incurred by some banks, whereas in the average for the  
9 banking system it wasn't as heavy as it appeared.

10 COMMISSIONER BROWN: At the moment and on the  
11 basis of the formula that is used, because of the  
12 relative experience in a 25 year moving average, the  
13 formula is declining at the moment?

14 MR. ELDERKIN: Yes.

15 COMMISSIONER BROWN: Is there any thought  
16 that there is a level below which it might stabilize  
17 and that it will not go below a certain level?

18 MR. ELDERKIN: Yes, there has been thought  
19 of that, Mr. Brown. The Minister has said that he will  
20 take a very careful look every year at the effect of  
21 the formula. However, it is not automatic to that  
22 extent; he can stop it at any level he sees fit to do.  
23 That is the reason I was very careful just to say that  
24 the formula will produce a figure, but whether it will  
25 be put into effect or not is something which I don't  
26 know at this stage.

27 The advantage of the formula as it is, if  
28 you have a moving average formula, is that the banks  
29 know about it in January of every year as to what is  
30 likely to be the percentage for the year. In other words,







1 we can produce this figure within a month, after we  
2 get the annual statements from the banks, because it  
3 is based on the history of the previous 25 years.

4 COMMISSIONER BROWN: It is obviously a  
5 point on which it is very difficult to arrive at any  
6 conclusion with any judgment as to <sup>the</sup> proper way to do it;  
7 you try and guess?

8 MR. ELDERKIN: Unless you are the seventh  
9 son of a seventh son or something like that. It is  
10 difficult; there is just no scientific way of establishing  
11 what the reserves should be.

12 The Minister has felt for some time that we  
13 should have a good historical background for this figure,  
14 and has felt in view of the fact that the loss experience  
15 for this particular selected period -- it doesn't need  
16 to be perfect by any means -- indicates a drop in the  
17 requirements, it should be given effect.

18 COMMISSIONER BROWN: Now, there are three  
19 matters involved in this whole question of a reserve;  
20 one, the distribution of the allowable, ,  
21 and this comes into focus with respect to the question  
22 of allowing it before income taxes, and the second one  
23 is the question of permitting it before income taxes  
24 -- which is not permitted in some jurisdictions -- and  
25 the third one is the question of secrecy.

26 There has been quite a lot of discussion  
27 in the United Kingdom and in the United States on this  
28 matter of secrecy; would you like to give us the  
29 picture as it exists at the moment in the United States?  
30 We know the situation in the United Kingdom because





1 there was a Royal Commission which brought forward some  
2 of this.

3 MR. ELDERKIN: Yes. The majority report  
4 on non-disclosure.

5 COMMISSIONER BROWN: And there is the other  
6 thing in the United Kingdom -- and this has to do with  
7 income tax, -- that in the United States it is on the  
8 same basis as in Canada, where there are tax exempt  
9 reserves?

10 MR. ELDERKIN: Yes. Well, the only thing  
11 that I can add as far as the United States is concerned  
12 is that the Federal Reserve has for some years advocated  
13 the disclosure, but there is no law which requires it  
14 in the United States that I know of. It has been the  
15 practice of many banks to disclose their reserves for  
16 a good many years, and the Saxon Report, to which I  
17 referred earlier, has come out with a recommendation  
18 for full disclosure of the reserves.

19 In 1954 I made the statement that disclosure  
20 in some cases may be a poor idea because of the wide  
21 fluctuations which take place in the reserves. One

22 cause of the fluctuations -- and a very substantial  
23 cause -- has been eliminated in taking away the reserves  
24 on Government of Canada and Provincial securities. This  
25 did cause very substantial fluctuations, and quite often  
26 at that time fluctuations which ran into, perhaps,  
27 \$100 million in pricing these securities at the market.  
28 That, of course, is no longer a factor because the  
29 securities do not require reserves by law now.  
30 Fluctuations will still take place, of course, but not







1 to the extent that they would have before.

2 COMMISSIONER BROWN: Well, in the United  
3 States is there any publication by the Comptroller of  
4 the Currency or other authorities?

5 MR. ELDERKIN: The Comptroller of the  
6 Currency publishes the total amount of the inner  
7 reserves of all national banks at December 31 in each  
8 year. That report comes out many months later, of course.  
9 Last year it was just about 2 per cent of the total loans.

10 Now, it might be quite a bit different than  
11 ours in this respect, as our reserve covers not only  
12 loans, or certain loans, but it covers certain letters  
13 of credit, and covers all securities outside of those  
14 of Canada and the provinces.

15 Their reserves cover only certain types of  
16 loans, and the way in which the Comptroller's report is  
17 written, he says "Two per cent of all loans", I am  
18 not at all sure whether he is talking there of related  
19 loans or all loans. I think it is 2 per cent of all  
20 loans. It may be higher with regard to what we would  
21 call related loans.

22 COMMISSIONER BROWN: May I ask a question?  
23 In view of that, in the United States, a tax-free item  
24 would, on the whole, be relatively much less than it  
25 would in Canada?

26 MR. ELDERKIN: On an average, Mr. Chairman,  
27 but it could be very substantially higher than it is in  
28 Canada in the case of an individual bank.

29 THE CHAIRMAN: Yes, but in view of the fact  
30 that the reserve is only against a certain portion of





1 the assets as compared to what it is in Canada. Am I  
2 right in that?

3 MR. ELDERKIN: Yes. They are not allowed a  
4 reserve against letters of credit unless the credit is  
5 in default, and they are not allowed a reserve against  
6 any securities unless the security is what is considered  
7 to be a bad debt or a partial bad debt.

8 I might just interject here, too, that in the  
9 United Kingdom, where only specific reserves are allowed  
10 against loans, no specific reserves are allowed against  
11 securities unless the securities are realized.

12 COMMISSIONER BROWN: Do you see where  
13 disclosure here, either on an overall basis or an  
14 individual basis, would hurt the banks?

15 MR. ELDERKIN: I don't know that it would hurt  
16 the banks, Mr. Brown. There are quite substantial  
17 fluctuations in these reserves even now. Whether this  
18 would be misinterpreted by the public, I don't know.  
19 It would certainly please the security analysts if you  
20 did this.

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1 COMMISSIONER BROWN: We are not  
2 necessarily working to please the security analysts.

3 MR. ELDERKIN: It is rather difficult  
4 to say. If you came to a period of a heavy run down  
5 on reserves because of losses, it might have some  
6 effect on the public. It might have more effect  
7 on the thinking of the bank management itself. There  
8 are advantages and disadvantages, and I would not  
9 want to weigh them too closely.

10 COMMISSIONER BROWN: Is there any  
11 evidence that the American banks which do publish  
12 these figures have suffered at all from such publi-  
13 cation?

14 MR. ELDERKIN: I can't document an  
15 answer to that; I have not heard of them.

16 COMMISSIONER BROWN: Perhaps I should  
17 rephrase my question, and ask you if you have seen  
18 any public comments which would indicate that there  
19 had been a reaction against any individual American  
20 bank which had published its figures and had suffered  
21 or experienced fluctuations.

22 MR. ELDERKIN: No. It must be  
23 remembered, however, that we should take into con-  
24 sideration the fact that they have been going through  
25 a period of good profitability, as we have been here,  
26 for a good many years, and reserves could not have  
27 suffered very much at any one stage.

28 THE CHAIRMAN: Do you know of any  
29 particular group of people, that is interested people  
30 such as depositors or shareholders of banks, who are







1 dissatisfied with the secrecy attached to the inner  
2 reserves?

3 MR. ELDERKIN: I don't know that I could  
4 mention a group, except the securities analysts, of  
5 course. I have never heard any protest from share-  
6 holders or depositors along that line.

7 The great argument in favour of  
8 disclosing the figures is possibly to give a truer  
9 valuation of the bank and to its shares, from the  
10 point of view of the public.

11 I might say also that there is an  
12 accounting factor here as well. The recommended  
13 American practice is that all assets should be shown  
14 at their book value -- that is gross -- on the asset  
15 side, and that all reserves should be shown on the  
16 liability side of the balance sheet as a capital  
17 reserve. Now, it is perfectly feasible, by means  
18 of write-downs or write-backs into this capital reserve,  
19 to keep it on a reasonably stable basis, unless you  
20 are running into something that you can't take care  
21 of in that way. This is an accounting problem.

22 COMMISSIONER BROWN: In other words,  
23 the analysts might be just as confused ....

24 MR. ELDERKIN: You might end up  
25 with being just as confused as you were in the  
26 first place, yes.

27 THE CHAIRMAN: I was curious to know  
28 whether any people who had interests in the bank from  
29 the point of view of shareholders or depositors have  
30 lodged any complaints with you.





1 MR. ELDERKIN: We have had several  
2 complaints, but I don't know how you would classify  
3 the people who sent them in, as to whether they were  
4 shareholders, depositors, or just persons who were  
5 interested in studying the values of the banks.  
6 You can get a complaint to the effect that the bank  
7 is burying profits which should be shown to the share-  
8 holders, to the public and to the depositors. I  
9 cannot say that outside of these people who are  
10 interested in analysing security valuations, that  
11 we have a group who have had any complaints.

12 If the recommended practice in the  
13 United States were adopted you would see a fairly  
14 substantial jump in the relative size of the balance  
15 sheet.

16 COMMISSIONER BROWN: That would off-  
17 set this in part by showing a reserve for potential  
18 income tax against it.

19 MR. ELDERKIN: It would do that, yes.  
20 The recommended American system is also that the  
21 operating statement should show the income tax that  
22 would attach to the profit which is transferred to  
23 reserve, if full income tax were paid on it, and to  
24 off-set that with a reserve for future income tax  
25 in the general loss reserve account. This does in  
26 effect give perhaps a truer picture of the year-to-  
27 year operations.

28 COMMISSIONER MACKINTOSH: Except that  
29 the income tax in the year in which the addition was  
30 made to reserves is the only income tax that can have







1 no relevancy to the ultimate value of that reserve.  
2 You do know that whatever income tax period it comes  
3 under, it is not the one for the year in which the  
4 additional reserves were made. Is that right?

5 MR. ELDERKIN: At the present time,  
6 you don't know from the income tax reported to what  
7 extent it is relevant to the current operations and  
8 to the transfers, if there have been transfers. You  
9 can make a pretty close estimate of that, but you  
10 don't know how much, for instance, of the transfers  
11 to inner reserves might have come out of non-taxable  
12 profits, nor do you know how much of the transfer  
13 from inner reserves came out of tax-paid reserves.

14 So, you are not quite sure at the  
15 present time, although you can make a pretty close  
16 estimate, as to how much is applicable to the present  
17 year and how much is not.

18 THE CHAIRMAN: We will recess now  
19 for fifteen minutes.

20  
21 --- Recess.

22  
23 THE CHAIRMAN: We will resume now.

24 COMMISSIONER MACKINTOSH: May I ask  
25 a question to clarify a point before Mr. Brown resumes?  
26 This may be a question you are unable to answer.

27 You mentioned that by a somewhat  
28 different formula trust companies were able to set  
29 up contingency reserves that had some similarity to  
30 those of the bank. Are there any other classes of





1 businesses that are permitted under the income tax law  
2 contingency reserves to which additions might be made  
3 before tax?

4 MR. ELDERKIN: I don't know of any,  
5 Dr. Mackintosh, that are spelled out in the Act.  
6 However, there is permission in the Act, in effect,  
7 for the Minister to allow certain types, not specified,  
8 to have non-taxed reserves. This is a matter of  
9 his judgment in many cases.

10 COMMISSIONER MACKINTOSH: So this is not  
11 unique -- neither for the banks nor for the financial  
12 institutions?

13 MR. ELDERKIN: I think it has always  
14 been part of the Canadian Income Tax Act -- certainly  
15 as long as I can remember -- that some discretion  
16 was left with the Minister of National Revenue to  
17 permit this type of reserve. A part of the banking  
18 system is that the Minister of Finance has that  
19 responsibility rather than the Minister of National  
20 Revenue.

21 COMMISSIONER MACKINTOSH: Before 1944,  
22 or thereabouts, did the privilege which was accorded  
23 to the banks come from the Minister of Finance?

24 MR. ELDERKIN: No.

25 COMMISSIONER MACKINTOSH: It came  
26 from the Minister of National Revenue?

27 MR. ELDERKIN: Yes.

28 COMMISSIONER MACKINTOSH: Just like  
29 any other company.

30 MR. ELDERKIN: That is right.





1 COMMISSIONER MACKINTOSH: Thank you.

2 COMMISSIONER LEMAN: Before we leave  
3 that subject, Mr. Elderkin, may I refer back to the  
4 answer to a question by Mr. Brown a few minutes ago  
5 when he asked you if the reserves had to be disclosed,  
6 what would be the effect? You made reference to  
7 its influence on management. One of the important  
8 arguments made is that it might inhibit management  
9 in its loan policy. Can you tell us a little bit  
10 of how you believe this would come about? Do you  
11 believe it would be much of an inhibiting factor?

12 MR. ELDERKIN: Well, this would  
13 depend on another factor, namely, how substantial  
14 their tax-paid reserves were. If they were well  
15 protected there, the reduction in their non-taxed  
16 reserves might not influence their lending policy  
17 to any great extent. If all reserves were getting  
18 to a low point, it might influence management. It  
19 would depend on the point of view at this stage, as  
20 to whether management felt that the low had been  
21 reached and that there wouldn't be any further impair-  
22 ment in the reserves, that they could afford to go on  
23 with the same policy they had been using in the past.

24 COMMISSIONER BROWN: Has it been an  
25 inhibiting factor in the United States?

26 MR. ELDERKIN: I couldn't answer  
27 that question. There are no tax/paid figures there; nobody  
28 outside the bank knows.  
29  
30







1 COMMISSIONER LEMAN: But were you referring  
2 to secrecy when you were discussing as to whether they  
3 were tax paid or non-tax paid?

4 MR. ELDERKIN: Again, this is difficult to  
5 answer accurately because we have passed through 20  
6 odd years of very good earnings, both here and in the  
7 States. Certainly, since the publication of loss  
8 reserves in the States has taken place I do not think  
9 they have been affected very seriously by the extent  
10 of their losses.

11 COMMISSIONER BROWN: Let us put it this way;  
12 has there been noticeably a more conservative attitude  
13 on the part of the managements of those banks in the  
14 United States that publish their reserves as compared  
15 with those banks that do not publish their reserves?

16 MR. ELDERKIN: I am not competent to answer  
17 that question, Mr. Brown. I do not know.

18 COMMISSIONER BROWN: When the insurance  
19 companies were with us we had quite a discussion about  
20 the lock-in effect of using amortized values of certain  
21 assets, and in talking about the use of amortizing  
22 values with respect to Government of Canada bonds in  
23 the chartered banks you made reference to the fact  
24 that the insurance companies had had this same privilege  
25 for some time. Has this had the same effect on the  
26 chartered banks?

27 MR. ELDERKIN: No, I do not think it has had  
28 any effect in that way whatsoever that I have observed,  
29 Mr. Brown. When the banks are required to sell bonds  
30 either for purposes of re-investment in, perhaps, more





1 profitable issues, or for re-investment in meeting  
2 loan demands, I do not think there has been any great  
3 hesitation just because they are going to take a loss  
4 on them.

5 COMMISSIONER BROWN: Against which they have  
6 not a reserve set up.

7 MR. ELDERKIN: That is right. I have never  
8 seen any evidence of it since that change was made  
9 there.

10 COMMISSIONER BROWN: From the point of view  
11 of their longer term bonds there must be quite a  
12 difference at the moment between amortized values and  
13 ---

14 MR. ELDERKIN: When the turnover comes it  
15 depends upon when they got into them... I think in most  
16 cases you will find, Mr. Brown, that when this partially  
17 forced liquidation takes place it would take place as  
18 far as possible in the shorter term.

19 COMMISSIONER BROWN: It always seems to be  
20 at a time when reserves are high and bond prices are  
21 low, and it seems to me that this would cause even  
22 greater reluctance on the part of the banks to take  
23 losses in order to make loans when they would have to  
24 take this loss at a time when they have not any  
25 reserve to counter it.

26 MR. ELDERKIN: I do not think we can talk  
27 entirely in that context. The banks may have more  
28 than sufficient -- and are likely to have more than  
29 sufficient -- current earnings to offset that loss.  
30 The fact that it is not chargeable to a reserve I do







1 not think influences them very greatly at this stage.  
2 Also, perhaps, there is a factor of competition here  
3 as well. If one bank does not sell its bonds to take  
4 care of its customers then another bank is likely to do  
5 so.

6 COMMISSIONER BROWN: You did refer to the  
7 Saxon report and its recommendations. Was there not  
8 some comment in the Saxon report about adequate reserves?

9 MR. ELDERKIN: In some cases I think so, but  
10 not in general. In the Saxon report there were two  
11 figures given; there was one bank with a  $2\frac{1}{2}$  per cent, and  
12 another bank with a  $6\frac{1}{2}$  per cent permitted maximum reserve.  
13 I do not recall offhand any statement to the effect that  
14 any particular bank had insufficient reserves, but in the  
15 very recommendation that was made, namely, that of a  
16 general reserve percentage greater than the maximum  
17 some banks now had, it was indicated that they felt  
18 these might be less than sufficient.

19 One has to take into consideration there two  
20 factors that enter into it. One is presumably any flat  
21 percentage which they recommended must have in mind  
22 taking care of a great number of small banks in the  
23 case of which the impact of losses on a ratio basis is  
24 liable to be greater than it is in the case of a bank  
25 which has a very large loan portfolio.

26 The second one -- and perhaps I should not  
27 mention this -- is that the committee was composed  
28 entirely of bankers, and there might have been some  
29 bias there.

30 COMMISSIONER BROWN: I thought they made a





1 recommendation about reserves being gradually built up  
2 to 5 per cent?

3 MR. ELDERKIN: That is correct. The gradual  
4 build-up is something that they have had in their  
5 regulations before. As a matter of fact, it is in the  
6 Income Tax Act in the provision permitting trust  
7 companies a reserve of 3 per cent. They can only build  
8 on a graduated basis. I think it is one-half of one  
9 per cent per year, but I am not quite sure of that  
10 figure. We have never considered that necessary in the  
11 banking system. We felt that if there was any deficiency  
12 below the permitted maximum that the banks should be able  
13 to restore it as quickly as possible out of their current  
14 earnings. This Saxon report, I think, calls for one-  
15 half of one per cent per annum until they build up to  
16 5 per cent, which I think is quite similar to the trust  
17 companies' 3 per cent procedure. They can go up to 3  
18 per cent.

19 COMMISSIONER MACKINTOSH: There is a small  
20 point there. If one were to assume that any particular  
21 bank was up to its ceiling on contingency reserves, and  
22 that when it fell below them it could get back to them  
23 in 3 years, the only place there would be any distortion  
24 of income in reporting would be in something less than  
25 the 3-year average. You would just be moving back and  
26 forth between that number of years?

27 MR. ELDERKIN: That is right.

28 COMMISSIONER BROWN: Have any of the other  
29 commissioners any further questions on this matter of  
30 reserves? There is a reference in the Bank Act to





1 requiring a two-thirds majority vote of the  
2 directors present at a meeting where a loan above a  
3 certain size is being considered to a corporation of  
4 which one of the directors is a shareholder. Would you  
5 see any benefits to having a somewhat similar procedure  
6 to that applicable in at least certain states where there  
7 is an absolute ceiling relative to the capital of the  
8 bank concerned on loans to any one customer?

9 MR. ELDERKIN: I do not think so in Canada.  
10 We have never felt it was necessary here. It would not  
11 be similar to a unit banking system in this respect.  
12 I know of only <sup>two</sup> countries outside of the United States  
13 that have this. Italy, I think, has a limit of 20 per  
14 cent, and if I remember correctly, in Denmark it is  
15 35 per cent, to any one customer. I have never seen  
16 any occasion here when any such loan would endanger the  
17 financial standing of the bank. In many cases these  
18 very large loans are of a quite temporary nature. They  
19 are usually pre-issue loans waiting for the security  
20 issue to pay them out, or they are for refinancing in  
21 one way or another. I, myself, do not think that a  
22 limit on individual loans is at all necessary in Canada  
23 with a national banking system.

24 COMMISSIONER BROWN: Under the Bank Act, as  
25 I recall it, the only statements that the banks are  
26 required to submit to their shareholders are balance  
27 sheets, and the earnings statements are fairly general.  
28 On the other hand, you publish in the Canada Gazette  
29 more detailed statements for the banks as a whole. Is  
30 there a disadvantage in requiring statements in this







1 sort of form to be published by individual banks?

2 MR. ELDERKIN: I think the viewpoints of the  
3 banks here are more important. They are certainly more  
4 important from their own point of view. Publishing  
5 individual statements in the form in which we publish  
6 them in the Canada Gazette, and table them in the House,  
7 would, of course, disclose the entire earnings of the  
8 current year, which is something that is not disclosed  
9 at the present time. In other words, this type of  
10 statement will produce the amounts transferred to inner  
11 reserves. We publish totals transferred out of inner  
12 reserves, and the net value of the two. Since you can  
13 obtain from the other statement the amount transferred  
14 out of the reserves you can get the amount that went  
15 in.

16 COMMISSIONER BROWN: Yes, I can see that  
17 there has been some change in the principle of inner  
18 reserves.

19 MR. ELDERKIN: You would also get the loss  
20 experience of that bank in the current year. It would  
21 be a very simple calculation.

22 COMMISSIONER BROWN: With respect to the  
23 statements that are published weekly and monthly by  
24 the banks, and which we discussed with the banks, and  
25 which they said they had nothing to do with because  
26 it was a requirement of the Act, there is this question  
27 of provincially guaranteed loans. With debentures or  
28 bonds there is a distinction in the sense that the  
29 provincial category also includes provincial guarantees,  
30 and corporate bonds are shown separately. When you get





1 down to loans, the loans are just loans to provinces,  
2 and the loans that are provincially guaranteed are here  
3 shown under corporates. I notice that in another list  
4 that you filed here you show the distinction. Under  
5 public utilities, transportation and communication  
6 companies there is a distinction as between those  
7 guaranteed by a province and others. I am wondering  
8 what is the logic behind having a loan that is guaranteed  
9 by a province to a corporation -- say, to a railway  
10 or a public utility -- placed under "Corporations",  
11 whereas once it becomes a bond it comes under "Provincial  
12 Guarantees".

13 MR. ELDERKIN: I think, insofar as securities  
14 are concerned, Mr. Brown, it is a matter of, perhaps,  
15 the viewpoint of liquidity. It may be thought that a  
16 provincially guaranteed bond is equally as liquid --  
17 there is a slight difference in price, perhaps -- as  
18 a provincially issued bond. When we get into the  
19 classification of loans we like to consider that loans  
20 guaranteed by a province, but not made directly to it,  
21 are a type of business loan for the carrying on of a  
22 business operation. That is about the only reason I  
23 can give you for the differentiation between the two.

24 As you can see, we at least make one break-  
25 down, and actually this is by far the major breakdown,  
26 as you can imagine. The remainder of the provincially  
27 guaranteed loans are very, very small outside of the  
28 public utility fields. There are some, I might add,  
29 that are guaranteed in effect, but not in fact.  
30 I am referring, for instance, to loans to a liquor







1 commission, which are also considered to be commercial  
2 loans.

3 COMMISSIONER BROWN: They are more liquid,  
4 is that right?

5 MR. ELDERKIN: Yes, much more liquid.

6 THE CHAIRMAN: In paragraphs 22 to 40 of your  
7 submission, Mr. Elderkin, you describe the three levels  
8 of bank inspection and supervision -- internal, share-  
9 holders' audit and your own operation. I understand  
10 that your view is that the present arrangements provide  
11 adequate protection to the public. I think you did  
12 indicate that.

13 MR. ELDERKIN: Yes, I think so. I think we  
14 have about as complete an inspection procedure as I  
15 have been able to find at any place in the world --  
16 that is, by statute, at least.

17 I do not want to draw invidious comparisons,  
18 but in the United States there is no statute, outside  
19 of those of some of the individual states, which lays  
20 down the requirements of inspection other than those  
21 of, perhaps, the Comptroller of the Currency and his  
22 own inspection. So far as the public audit is con-  
23 cerned, or the internal audit is concerned, it is left  
24 entirely to the discretion of the bank as to whether  
25 it is done by the directors or done by independent  
26 auditors. As a matter of fact, the Saxon report  
27 continued this recommendation, much to my surprise.

28 THE CHAIRMAN: Can you elaborate a little  
29 bit upon your own functions as Inspector General. Give  
30 us an idea of exactly how you operate including some





1 details of your very effective staff.

2 MR. ELDERKIN: Well, my very effective staff,  
3 and the size of it, Mr. Chairman, is to a great extent  
4 due to the powers which come to the Minister under the  
5 Bank Act to influence, if necessary, the audit carried  
6 out by the shareholders' auditors. Of course, this  
7 authority flows down to me. In other words, I can  
8 prescribe any additions to the audit procedure that the  
9 auditors carry out, and they are required to do  
10 them.

11 We have no authority -- and we would not  
12 exercise it if we had -- to reduce an audit procedure  
13 which the auditors decided was necessary. We know what  
14 the auditors have done in all cases because we have on  
15 file the audit procedures that are being carried out,  
16 and we do check them from year to year to see if any  
17 changes have taken place in the level of loans that are  
18 examined, and in the amount of inspection which is done  
19 at branches of the banks in various large cities.

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1 Further, I have the authority to examine  
2 the working papers of the auditors after they have  
3 completed their work. This is not done physically  
4 but it is often done verbally in discussions with  
5 them.

6 As far as the actual work of the office  
7 is concerned, it therefore is possible to bring it  
8 down to a system which enables us to avoid duplication  
9 in so far as this is possible to accomplish. We re-  
10 ceive monthly reports on many things such as the  
11 larger loans, not by individual loans but by amounts  
12 and number, and so on, and we receive quarterly reports  
13 on classifications of loans. This we consider quite  
14 an important type of report because we are watching  
15 the fluctuations between various classifications, and  
16 if one seems to be particularly active and perhaps  
17 out of line we start to make inquiries as to why  
18 this has occurred.

19 We receive half-yearly reports on the  
20 securities held for investment and in trading account  
21 by the banks, together with their market valuation,  
22 which is checked at this end as well.

23 As for physical examination, as I mentioned  
24 before, last year we received a very substantial  
25 number of reports, 3,200 in total, covering individual  
26 loans with an aggregate of more than \$4,100 million. These  
27 reports, as I described to Mr. Leman a short time ago,  
28 contain a substantial amount of information as to  
29 the latest balance sheet and profit and loss statements,  
30 and also as to security and as to satisfactory or un-







1 satisfactory operation.

2                   These are scanned very closely at the  
3 office and if any of them show any signs of weakness  
4 that can be determined from the reports, they are  
5 then put to one side for the physical examination  
6 which takes place at the head office of the bank.  
7 There the files are presented, and these files in  
8 our system are very informative because they are likely  
9 to contain the comments of the branch manager,  
10 district supervisor, the head office credit officer,  
11 and the assistant or perhaps the general manager.

12                   We then discuss these with credit  
13 officers and with executive officers to see what  
14 steps are being taken to put the account in a satis-  
15 factory condition.

16                   This is the main physical operation at  
17 the head office, with the exception of examining,  
18 for the purpose of advising the Minister, the inner  
19 reserves of the banks to see if they have been kept  
20 within the prescribed limit, because he is charged  
21 with the responsibility of informing the Minister  
22 of National Revenue if they have exceeded the limit.  
23 So, at the conclusion of every examination I am  
24 required by statute to make a report to the Minister,  
25 and part of the report is on the financial standing  
26 of the bank, and part of it is on the inner reserves  
27 of the bank. He then advises the Minister of National  
28 Revenue that in his opinion the bank has not exceeded --  
29 at least this has been true in the past ten years --  
30 the prescribed limit on the non-taxed reserves.





1                   COMMISSIONER LEMAN: Mr. Elderkin, does  
2 that mean that the Department of National Revenue  
3 does not have to perform any kind of audit in this  
4 field?

5                   MR. ELDERKIN: Not in the reserve field,  
6 Mr. Leman. No, this is quite separate. They do  
7 perform an audit and an assessment of what the bank  
8 claims as tax-paid reserves to see that the reserves  
9 have actually been tax-paid, but on the non-tax  
10 reserves the responsibility rests with the Minister  
11 of Finance.

12                  THE CHAIRMAN: What are your responsibilities  
13 in connection with the inspection of foreign operations  
14 of Canadian banks?

15                  MR. ELDERKIN: Here again we receive  
16 regular reports. It so happens at the present time  
17 the ones during the year are channelled through the  
18 Bank of Canada showing the position in foreign  
19 currencies which a bank has, and once per year  
20 a very detailed report is received showing the position  
21 in sterling and U.S. dollars and other currencies,  
22 and the type of assets and liabilities that are  
23 involved.

24                  During its operations in a year a bank  
25 may possibly be short on spot, but it is the practice  
26 of all banks to keep a net long position except for  
27 casual shortages which may occur overnight and that  
28 sort of thing, but whenever they are short on spot  
29 funds they will be covered by forwards.

30                  I can say that as far as all currencies







1 outside of sterling and U.S. dollars are concerned,  
2 the banks are required in the country where they  
3 are operating to keep a long position, to keep  
4 reserves quite often in local government bonds, et  
5 cetera, in what is quite commonly known as registered  
6 capital.

7 We do not get any shortages in these  
8 places at any time. As far as the United Kingdom  
9 is concerned the requirements are not there but the  
10 banks do keep a long position practically all of the  
11 time. They have to in order to do the international  
12 business they are doing there. The same is true  
13 in the United States with some exceptions where the  
14 bank may be short on spot but will be covered by  
15 forwards.

16 THE CHAIRMAN: Is there any degree of  
17 co-operation between you and the foreign authorities  
18 in your inspection of the foreign business of a  
19 bank? Have you any contact with the foreign  
20 authorities at all in connection with that?

21 MR. ELDERKIN: No, and I do not think it  
22 is necessary, Mr. Chairman, because it is all on  
23 record in the head office of the bank.

24 THE CHAIRMAN: How do you interpret the  
25 Bank Act requirement that banks maintain adequate  
26 liquidity against foreign currency liabilities?

27 MR. ELDERKIN: Just that, Mr. Chairman,  
28 that they must have on call or on hand sufficient  
29 liquidity to take care of their liabilities.

30 THE CHAIRMAN: You operate with a smaller





1 staff than most other government institutions, I  
2 understand.

3 MR. ELDERKIN: I am the white-haired  
4 boy sometimes. This goes back to what I said a  
5 while ago. In setting up our program we have  
6 endeavoured in so far as possible to use responsible  
7 shareholders' auditors, and they must be responsible  
8 under the provisions of the Bank Act, and we avoid  
9 duplication. We ask the banks to do a great amount  
10 of the paperwork that is involved.

11 I told you a few minutes ago of the  
12 numerous reports that we get that are made out and  
13 furnished by the banks, and this of course obviates  
14 any necessity for sending staff in to turn them out  
15 at much more cost. In our setup here it would be  
16 very expensive to operate in any other way, for you  
17 would probably have a staff that you could keep busy  
18 for six months of the year and which would have very  
19 little to do for the other six months of the year.  
20 Furthermore, I think this particular system is more  
21 efficient because you are having your reports prepared  
22 by people who are familiar with the work, and this  
23 leaves to you the responsibility of seeing that they  
24 are correct.

25 THE CHAIRMAN: You have contacts with  
26 the Bank of Canada from time to time, have you?

27 MR. ELDERKIN: Oh, yes, very definitely.

28 THE CHAIRMAN: And information is  
29 obtained from the Bank of Canada?

30 MR. ELDERKIN: That is right. For





1 instance, if we are interested in something of an  
2 industry research, as we have been : sometimes in the  
3 past, I would turn to the Bank of Canada to see what  
4 they have and how much help they could give me, and  
5 if they have anything it is always available.

6 THE CHAIRMAN: Do you supply the Bank  
7 of Canada with information at all?

8 MR. ELDERKIN: Certain informatinn  
9 passes through my office, yes. For instance,  
10 information regarding the classification of loans  
11 comes to me and then it is supplied to the Bank of  
12 Canada. Information as to the classification of  
13 deposits, the combined statement of income and  
14 expenditure, et cetera, these things that you find  
15 published in the Bank of Canada Statistical Summary,  
16 you will note, are underlined by "Source, Department  
17 of Finance," which in this case means my office.

18 THE CHAIRMAN: Is that work which  
19 is perhaps not directly connected with your position  
20 as Inspector?

21 MR. ELDERKIN: No, it does not relate to  
22 the direct inspection in every way, if that is what  
23 you mean, Mr. Chairman.

24 THE CHAIRMAN: No, but if certain  
25 statistics are available to you that are of interest  
26 to the Bank of Canada you would supply it as a courtesy,  
27 would you?

28 MR. ELDERKIN: I am permitted by the  
29 Bank Act to give them any information which I obtain  
30 and which I see fit to hand over.







1 THE CHAIRMAN: There was some suggestion  
2 that your office should be attached to the Bank of  
3 Canada rather than to the Department of Finance, as  
4 it is now.

5 MR. ELDERKIN: That is right.

6 THE CHAIRMAN: Have you any views as  
7 to such a proposal?

8 MR. ELDERKIN: This proposal has come  
9 up on several occasions in the past, Mr. Chairman.  
10 There are advantages and disadvantages either way  
11 you look at it. For the Bank of Canada it probably  
12 would be in many ways a distinct advantage to have  
13 the inspection carried out by one of their officers.  
14 They would be in very much closer touch and, to use  
15 a phrase, they would have a better feel perhaps of  
16 what was going on in the banking system or in  
17 individual banks if they could go in at any time  
18 they wished to obtain information. To go through  
19 this particular exercise would form a training ground  
20 for officers of the Bank of Canada. It would provide  
21 for the training of a successor, which is one of  
22 the weaknesses in the office at the present time.  
23 Because of the very size of it, it is not worthwhile  
24 trying to get any really competent person as an  
25 assistant during the normal tenure of office. If  
26 it came under the Bank of Canada, possibly one person  
27 after another would be trained to carry on and there  
28 would be no gap in the case of a casualty.

29 Many of the advantages which would  
30 go to the Bank of Canada for having the office there





1 could also be obtained by giving the Bank of Canada  
2 the authority to obtain such information as they wished,  
3 such as the Federal Reserve has in the United States  
4 and such as the Bank of England has in the United  
5 Kingdom. On the other side of the coin there are  
6 several other duties assigned to the Inspector General  
7 of Banks in the Department of Finance. For one thing  
8 he is the banking adviser to the Minister. He or  
9 his office takes care of practically all correspondence  
10 affecting banking which comes to the Department of  
11 Finance, including inquiries and sometimes complaints.  
12 The Inspector General of Banks appears as a witness  
13 before Commissions on behalf of the government,  
14 and likewise  
15 he appears before parliamentary committees under the  
16 same authority.

17 His office compiles all the statutory  
18 returns for publication, and he advises and assists  
19 in the preparation of banking legislation. If the  
20 office were moved to the Bank of Canada, there would  
21 have to be a certain amount of this provided for  
22 anyway in the Department of Finance.

23 THE CHAIRMAN: Well, does information  
24 of a confidential nature come into your hands which  
25 might not be appropriate to send on to the Bank of  
26 Canada?

27 MR. ELDERKIN: We have some ground  
28 rules on that, as a matter of fact, Mr. Chairman,  
29 but it always raises the question as to whether I  
30 am any more responsible than is the Governor of the







1 Bank of Canada or his staff in connection with  
2 confidential information. It is questionable.

3 THE CHAIRMAN: What are the ground  
4 rules?

5 MR. ELDERKIN: We do not normally  
6 pass over information regarding individual accounts.  
7 That is about the only ground rule there is. I do  
8 not say we never do, for sometimes we practically  
9 have to when explaining some large differences which  
10 occur, but ordinarily we do not furnish any written  
11 information regarding individual accounts.

12 THE CHAIRMAN: Have you any views  
13 as to whether the Bank of Canada should be provided  
14 with information of that kind as to individual accounts?

15 MR. ELDERKIN: I think the Bank of  
16 Canada is very much more able to answer that than I  
17 am. As far as I have ever known, the only information  
18 regarding individual accounts they have been interested  
19 in has been in connection with an explanation of  
20 a particular trend that has been taking place in  
21 the classification of loans, or something of that  
22 nature. If a very large difference appeared  
23 all of a sudden in a loan classification they would  
24 probably be interested in knowing whether this was  
25 something that was very temporary or whether it was  
26 something likely to exist for some time to come,  
27 whether it was a trend or just an individual instance.

28 COMMISSIONER BROWN: I wonder if I may  
29 ask a question on this? The Act provides for what  
30 you do, and it says:





1 "...for the purposes of satisfying  
2 himself that the provisions of this  
3 Act having reference to the safety  
4 of the creditors and shareholders  
5 of the bank are being duly observed  
6 and that the bank is in sound financial  
7 condition, and at the conclusion  
8 of each examination and inquiry  
9 shall report thereon to the Minister."

10 Have there been any protests by the banks about  
11 information that you receive for this purpose being  
12 handed to the Bank of Canada for another purpose?

13 MR. ELDERKIN: Sometimes banks have  
14 protested that they feel that information regarding  
15 individual accounts should not be handed to the Bank  
16 of Canada, yes, under the present circumstances, and  
17 this is partially due to the fact that the Bank of  
18 Canada has not the authority to obtain this information  
19 themselves.

20 COMMISSIONER BROWN: That is what I  
21 was going to ask you. Do you think it might not  
22 be more appropriate, if it was thought advisable in  
23 the public interests that the Bank of Canada should  
24 have access to such information, it be given this  
25 right itself rather than placing you in the position  
26 of having to give information which you receive for  
27 one purpose to another authority to be used for quite  
28 a different purpose?

29 MR. ELDERKIN: I agree entirely.  
30





1 COMMISSIONER MACKINTOSH: I would like to  
2 ask a question to clarify, perhaps, this section.

3 You have given us, Mr. Elderkin, a very clear  
4 and useful statement of your own duties and the duties  
5 of the shareholders' auditors. I gather from what you  
6 have said, and other things, that the basis of a good  
7 deal of this work is the internal audit of the bank,  
8 and the bank's own inspection procedures.

9 Are there any essential features of the  
10 legislation which tend to ensure the effectiveness of  
11 the internal audit, or how do you go about ensuring  
12 that the internal audit is effective?

13 MR. ELDERKIN: There is no legislation, Dr.  
14 Mackintosh; this becomes a responsibility not only on  
15 my part, but also on the part of the shareholders'  
16 auditors. They have to satisfy themselves that the  
17 internal inspection procedure is adequate, and this is  
18 something that is very much in their mind as it is in  
19 mine, and which we discuss from time to time.

20 In some cases the shareholders' auditors will  
21 attend with the inspectors at the large branches,  
22 particularly where there may be some security holdings  
23 and where the larger loans probably are held.

24 Admittedly, a lot of the internal inspection  
25 by the bank's own staff is in connection with the  
26 operation of the branch, and whether there is any fraud  
27 or whether the branch is carrying out its proceedings  
28 and its business in a competent way and whether the  
29 reports that are being made to head office are correct  
30 in every way, and in operation the shareholders' auditors







1 take upon themselves the duty of seeing that this type  
2 of an inspection is being carried out.

3 Now, I in turn depend upon the shareholders'  
4 auditors to see that this is done because it is all  
5 part of their audit procedure and they couldn't, under  
6 a national system such as we have, turn out their report  
7 on the financial statement in the time they do unless  
8 they did assure themselves that the internal inspection  
9 was adequate.

10 COMMISSIONER MACKINTOSH: I notice in  
11 the legislation that the Minister has power to disqualify  
12 any shareholders' auditor?

13 MR. ELDERKIN: That is right.

14 COMMISSIONER MACKINTOSH: Has this ever arisen,  
15 do you know?

16 MR. ELDERKIN: No, not since --- certainly  
17 not since the 1954 amendment. Prior to 1954 -- if you  
18 would like a little history -- prior to 1913 shareholders'  
19 auditors were not shareholders' auditors at all; in  
20 effect they were appointed by the directors. Now,  
21 this continued up until about 1923, when there was  
22 a takeover of a bank which would have failed otherwise  
23 and where it was discovered that there was very  
24 incompetent auditing, both internally and by the  
25 appointed auditors. That is when the Act was amended,  
26 as a matter of fact, to bring in shareholders' auditors  
27 of a standing which was satisfactory to the Minister,  
28 and this immediately produced a situation in which we  
29 had the Home Bank failure, because as soon as competent  
30 auditors got into the Home Bank, it was closed up.





1 This also brought about the office of the Inspector  
2 General of Banks, too, the same year.

3 Well, the first requirement in this respect  
4 was that there was a panel selected by the banks, and  
5 if the Minister did not disapprove of anyone on the  
6 panel, the banks might select any two of those persons  
7 to become the auditors.

8 This procedure was changed in 1954 to the  
9 effect that the qualifications were spelled out in the  
10 Act that he had to be a member of a provincial  
11 Institute of Accountants who had been in practice for  
12 at least six years, I think it is, and, of course, to-  
13 day all of the auditors of the chartered banks are  
14 senior partners of very well established firms of  
15 chartered accountants, and therefore the filing of these  
16 voluminous panels was abolished, and now the legislation  
17 is in a negative form, that unless the Minister  
18 disapproves the appointment stands. The Minister has  
19 never disapproved since 1954, no. The Minister did,  
20 prior to 1954, on one occasion take a name off the  
21 panel.

22 THE CHAIRMAN: When the Minister deals with  
23 a situation of that kind and he considers whether or  
24 not a name should be disapproved of, whose advice does  
25 he seek?

26 MR. ELDERKIN: Mine, I guess, Mr. Chairman.

27 THE CHAIRMAN: That is what I thought.

28 MR. ELDERKIN: And sometimes the record in  
29 other respects but, as I say, this has never happened  
30 under the present --- not since 1954. It did happen







1 | once in the previous ten years.

2 | THE CHAIRMAN: Well then, you scrutinize  
3 | the list of auditors who are active in this field?

4 | MR. ELDERKIN: Yes, we keep a continuing  
5 | list of auditors.

6 | THE CHAIRMAN: What system have you for  
7 | rating them?

8 | MR. ELDERKIN: You don't rate them; the Act  
9 | says that they must be members in good standing of a  
10 | provincial Institute of Accounting, and this is really  
11 | the only qualification that they require, outside of  
12 | the fact that they must have been in continuous practice  
13 | for a period of at least six years. In effect, there  
14 | is no need of further rating because, as I mentioned  
15 | before, Mr. Chairman, without exception I think that  
16 | these are senior partners in very well established  
17 | accounting firms.

18 | THE CHAIRMAN: Well, if some of them were not  
19 | senior partners, but in a much more junior position ---

20 | MR. ELDERKIN: Well, here is a matter ---

21 | THE CHAIRMAN: --- what considerations would  
22 | you take into account in determining whether a certain  
23 | person was qualified for that sort of position or not?  
24 | This is a hypothetical question.

25 | MR. ELDERKIN: To a certain extent, yes. I  
26 | was going to say, being a chartered accountant myself,  
27 | you see, that I would believe any chartered accountant  
28 | was good if he had been in practice for six years  
29 | and had nothing against him up to that stage!

30 | THE CHAIRMAN: Well, it must be a very unusual





1 profession!

2 MR. ELDERKIN: Oh, it is.

3 COMMISSIONER LEMAN: Is their remuneration  
4 voted on at the shareholders' meeting?

5 MR. ELDERKIN: Always at the shareholders'  
6 meeting. They may have supplementary remuneration for  
7 some individual investigation or exercise they may carry  
8 out if it is voted on by the directors, but not other-  
9 wise.

10 This is one of the troubles that did occur  
11 in the past. It would appear that many years ago --  
12 and this is very many years ago -- the so-called share-  
13 holders' auditor received remuneration in any form.

14 It is now specified in the Act that payment has to be  
15 authorized by the shareholders for the general audit or,  
16 for other examinations, by the directors.

17 The "other examination", Mr. Leman, almost invariably  
18 is likely to be matters of tax problems, and that sort  
19 of thing, which may arise.

20 THE CHAIRMAN: Have you ever considered the  
21 possible advantages of having a single operation for  
22 the inspection and supervision of other financial  
23 institutions in addition to the chartered banks? That  
24 is, financial institutions that carry on deposit  
25 business particularly?

26 MR. ELDERKIN: Well, I gather you do not  
27 want me to refer to the constitutional problems here?

28 THE CHAIRMAN: No.

29 MR. ELDERKIN: Well, if we take the chartered  
30 institutions, the other ones, of course, are the trust





1 and loan companies, insurance companies, small loan  
2 companies, and I don't know what audit procedure they  
3 carry out, and I don't know whether any substantial  
4 savings would be affected or not. In all these fields,  
5 you have to have a certain amount of expertise for each  
6 division, and whether it would be possible for the  
7 examining authorities to use the system which we use, --  
8 if it were incorporated in the legislation -- I don't  
9 know, and I don't know what the results would be.

10 There are some cases where it may be said  
11 that federal inspection crosses provincial lines, with  
12 the consent of the provinces. The Superintendent of  
13 Insurance is by legislation the Superintendent of  
14 Insurance in three provinces as well : under particular  
15 provincial legislations.

16 If we were getting into an examination of  
17 other credit institutions, such as credit unions and the  
18 caisse populaires, here again you would need some  
19 specialization, it is perfectly true, and if this were  
20 constitutionally possible or arranged with the approval  
21 of the particular subject institution, it could be done  
22 but it would require a very major staff to do it,  
23 because you have such a widespread number of offices  
24 that you have to inspect, probably, unless you made  
25 some arrangements whereby, in the case of the credit  
26 unions and caisses populaires, that they functioned in  
27 very much the same way as the chartered banks by  
28 operating through their centrals or their unions in  
29 Quebec. This is, I think, possible.

30 THE CHAIRMAN: Have you any suggestions or







1 recommendations to make as to improvements in the  
2 system of bank inspection and supervision?

3 MR. ELDERKIN: No, but I have in the past  
4 at times. I think we have reached a very satisfactory  
5 stage, Mr. Chairman.

6 THE CHAIRMAN: I don't know that it will be  
7 of very much service to put this question to you.  
8 That is, the difference in your view between the  
9 activities of so-called near-banks and those of the  
10 banks themselves, that is, as to their functions. First,  
11 may I put this to you; what do you consider to be the  
12 peculiar function of a bank as opposed to other types  
13 of financial institutions?

14 MR. ELDERKIN: Well, Mr. Chairman, I did  
15 put on record, as you know, a considerable number of  
16 legal opinions and legal decisions.

17 THE CHAIRMAN: I was asking for your view.

18 MR. ELDERKIN: Well, I would not be reluctant  
19 if you will, in saying that I rather agree with what one  
20 authority said, that it is in effect a combination of  
21 accepting deposits from the public with an obligation  
22 to pay them out on demand by cheque, or order. This,  
23 I think, constitutes a primary function of the bank.  
24 There are very many others, as a matter of fact.

25 THE CHAIRMAN: This is simply your view?

26 MR. ELDERKIN: That is right, it is also the  
27 view of the ---

28 THE CHAIRMAN: I am not suggesting it is  
29 your legal opinion.

30 MR. ELDERKIN: Oh no.





1 THE CHAIRMAN: This is your view from a  
2 practical point of view?

3 MR. ELDERKIN: Yes. I think I might read  
4 to you what a very outstanding authority has said on  
5 this. This is Mr. Falconbridge, who is considered to  
6 be one of the finest constitutional law lawyers we  
7 have, and he said this in his sixth edition on Banking  
8 and Bills of Exchange. He said:

9 "primarily the business of a bank consists  
10 in the receipt of deposits from customers  
11 and the payment of its customers' cheques  
12 and this appears to be the consensus of  
13 legal opinion."

14 THE CHAIRMAN: Well then, you would consider  
15 the deposit business the banking business?

16 MR. ELDERKIN: The deposit business coupled  
17 with the chequing business.

18 THE CHAIRMAN: Yes. Well, I was using the  
19 term broadly; that an institution that carried on that  
20 sort of business would, insofar as that part of its  
21 business was concerned, be carrying on a banking  
22 function, in your view?

23 MR. ELDERKIN: It seems to me that that is  
24 it.

25 THE CHAIRMAN: From a practical point of  
26 view?

27 MR. ELDERKIN: Yes, from a practical point  
28 of view. I am not a lawyer; I can't give a legal  
29 point of view.

30 THE CHAIRMAN: Well, it doesn't prevent you







1 from being right!

2 COMMISSIONER MACKINTOSH: You do know what  
3 is under federal jurisdiction is banking and not banks?

4 MR. ELDERKIN: That is right. Well, the use  
5 of the word "bank" is under federal jurisdiction.

6 COMMISSIONER LEMAN: Mr. Elderkin, if as an  
7 institution you merely took deposits from the public  
8 and did not invest the money at all, and purely charged  
9 the customers for the service of managing the system  
10 without investing those funds and without making loans,  
11 etcetera, then, according to what you have just said,  
12 that would be a bank?

13 MR. ELDERKIN: I would say they were carrying  
14 on the banking business. I wouldn't say they were a  
15 bank under the Act.

16 COMMISSIONER LEMAN: Would it be profitable  
17 if they charged their customers enough for the service?

18 MR. ELDERKIN: That is right, if you could  
19 get anybody to operate on that basis, Mr. Leman.

20 THE CHAIRMAN: Have you any view as to the  
21 limitations on the business of banking? For instance,  
22 has it been decided that banks may not carry on a trust  
23 business?

24 MR. ELDERKIN: No, Mr. Chairman; the banks,  
25 as you know, are statutory corporations and they have no  
26 powers except those that are given to them by legislation.  
27 The peculiarity that arises here is that the savings banks  
28 are chartered banks and the chartered banks are not  
29 chartered banks, because the only charter they have is  
30 the Bank Act, and their charters are repealed immediately  
by the Bank Act, this charter that they receive from  
Parliament.





1                   Therefore, there is always the question  
2 as to how far they can go in that catch phrase, if  
3 you will, in Section 75 permitting them to carry on  
4 business pertaining to banking.

5                   I could be legally wrong on this, but I  
6 think it is questionable whether one could consider  
7 a fiduciary capacity as a business pertaining to  
8 banking. So far as business pertaining to banking  
9 goes, it has been described by several authorities.  
10 One authority has said that where it is referred  
11 to in the Bank Act it is meant that the bank may  
12 conduct transactions and give agency services to  
13 customers where these are related in a reasonable  
14 manner to the fundamental operations of banking.

15                  If we take that definition, I think this  
16 rather eliminates the fiduciary capacity.

17                  THE CHAIRMAN: You have to look at the  
18 provisions of the Act itself and determine to what  
19 extent they might apply to any set of circumstances.

20                  MR. ELDERKIN: Yes.

21                  THE CHAIRMAN: It is quite different from  
22 a corporation that is formed by royal charter.

23                  MR. ELDERKIN: That is true. A natural  
24 corporation has all the powers normally that an  
25 individual would have, unless otherwise prohibited.

26                  THE CHAIRMAN: Are the Quebec Savings  
27 Banks by charter?

28                  MR. ELDERKIN: They are by charter. Their  
29 charter has not been completely repealed by the Act,  
30 but their powers under the charter have been repealed





1 by the Act. In effect, they operate under the Act.  
2 There is, however, one difference, and it is a  
3 minor one. If they went ahead and violated pro-  
4 visions of the Act -- did something that they are  
5 not permitted to do by the Act, -- they have committed  
6 a violation, if you will, but this does not mean the  
7 act they did is void. Whereas, with a statutory  
8 corporation like a bank, the act is void, if they  
9 do something they do not have the power to do.

10 COMMISSIONER BROWN: How do they interpret  
11 in the matter of banking the question of handling  
12 real estate?

13 MR. ELDERKIN: When you say "handling  
14 real estate", do you mean their own real estate?

15 COMMISSIONER BROWN: The large buildings  
16 which the banks have, parts of which they may lease  
17 out to other people.

18 MR. ELDERKIN: That question has come  
19 up for discussion quite often. The viewpoint there  
20 is that the bank builds a large building for a head  
21 office or for its main branch in a large community;  
22 first, it builds on land which is so valuable that  
23 no small building could economically be put on it;  
24 secondly, the bank is providing for the future. We  
25 have seen this happen time and time again, where the  
26 bank may take only seven floors of a building that  
27 is just completed, but within ten years the bank may  
28 want another seven floors. In that way, they are  
29 providing for their future, and are only interested  
30 in renting out available space until such time as it







1 is needed. True, some of it they may never need.

2 COMMISSIONER MACKINTOSH: It does not  
3 always validate the top twenty storeys.

4 MR. ELDERKIN: That is true. The only  
5 validation for it that I can think of is that first  
6 you are carrying the cost of the land, and possibly  
7 you have some advertising value ---

8 COMMISSIONER BROWN: Is advertising part  
9 of the function of a bank?

10 MR. ELDERKIN: For their own use, I would  
11 say so.

12 COMMISSIONER BROWN: I was wondering if  
13 the Act should not be clarified a bit on that point.

14 MR. ELDERKIN: In one place in the Act  
15 reference is made to buildings for their own use.  
16 In many cases also these buildings are not held by  
17 the bank, but by a subsidiary real estate corporation.  
18 In fact, most of the large bank buildings today do  
19 not belong to the bank, but are held by a subsidiary  
20 realty corporation. The main purpose of this is  
21 that the realty corporation can issue bonds and  
22 debentures on a long-term basis, whereas the bank  
23 has no authority to issue bonds and debentures.

24 COMMISSIONER BROWN: I hope you are not  
25 suggesting that the banks are thereby doing something  
26 they could not otherwise do under the Act.

27 MR. ELDERKIN: No, I do not think they  
28 are in this particular case. They are entitled to  
29 control a realty corporation, directly under the Act.  
30 You will find that in Schedules M and N, which imply





1 | they can control a realty corporation.

2 |                   COMMISSIONER BROWN: Yet it is not  
3 | specified under the Act.

4 |                   MR. ELDERKIN: That they may invest?

5 |                   COMMISSIONER BROWN: Yes.

6 |                   MR. ELDERKIN:           They may invest  
7 | in any corporation, Mr. Brown.

8 |                   COMMISSIONER BROWN: Somehow this has  
9 | been interpreted that they cannot acquire full ownership  
10 | of a trust company. I was wondering why there is  
11 | this distinction. It is perfectly legal for them  
12 | to acquire full ownership in a realty company, and  
13 | thereby enable them to issue long term bonds and this  
14 | sort of thing, which they could not do themselves?

15 |                   MR. ELDERKIN: They can. There is  
16 | nothing in the Act which prevents them from acquiring  
17 | full ownership of trust companies. If they did they  
18 | would have to publish the financial statement of the  
19 | trust companies as an annex to their own financial  
20 | statement. The banks do, as a matter of fact, own  
21 | several trust companies abroad, outside Canada.  
22 | They own trust companies in New York and in the  
23 | Caribbean, which carry on a subsidiary business in  
24 | those particular places. For the most part these  
25 | trust companies in New York are for the purpose of  
26 | acting as registrars or transfer agents for Canadian  
27 | securities, and don't do very much business with the  
28 | public, if any.

29 |                   COMMISSIONER BROWN: But somehow there  
30 | has been a timidity on their part to acquire full







1 ownership of the trust companies in Canada.

2 MR. ELDERKIN: As I said before, that is  
3 partially because they would be required to publish  
4 all statements of the trust company as an annex  
5 to their own statement. This may have something to  
6 do with it.

7 COMMISSIONER BROWN: May I ask one other  
8 question related to this point? Do your inspection  
9 powers extend to these wholly owned subsidiary companies?

10 MR. ELDERKIN: No, but the Act provides  
11 that the auditors of the bank must be the auditors  
12 of the fully controlled realty company, and I have  
13 access to that.

14 THE CHAIRMAN: Apparently that is not  
15 considered as carrying on business indirectly?

16 MR. ELDERKIN: It never has been, Mr.  
17 Chairman. This has been the practice for long before  
18 my time, and nothing to the contrary has ever been  
19 considered.

20 THE CHAIRMAN: It has never been  
21 questioned?

22 MR. ELDERKIN: Never been questioned.  
23 The only question that has arisen, as Dr. Mackintosh  
24 indicated, is what do you do with the top twenty  
25 storeys.

26 THE CHAIRMAN: I can understand that  
27 they might be a little hesitant about obtaining  
28 control of a trust company. If they did so, it  
29 might be thought that there should be an amendment  
30 to the legislation to prevent them from doing so.





1 debenture holders?

2 MR. ELDERKIN: In any European country  
3 I have had contact with the only security behind  
4 the debenture or bond is a certain specified block  
5 of mortgages; otherwise, after that they would  
6 rank as a normal creditor, if they did not realize  
7 out of the mortgages.

8 COMMISSIONER LEMAN: Would they be  
9 junior to the depositors or equal with them?

10 MR. ELDERKIN: I can't answer that,  
11 but I would think they would be on the same basis  
12 as the depositors.

13 COMMISSIONER MACKINTOSH: You said  
14 a moment ago that the Canadian banks did not issue  
15 debentures. Are they prohibited by the Act from  
16 doing so?

17 MR. ELDERKIN: The Act does not allow  
18 them to do so. There again, they would have to  
19 have special provision in the Act being statutory  
20 corporations. This, from the point of view of banks,  
21 would be much cheaper money.

22 THE CHAIRMAN: Do you see any operating  
23 problems arising if the method of calculating cash  
24 reserve requirements were changed to a two-week  
25 reserve period instead of the present period?

26 MR. ELDERKIN: Mr. Chairman, you  
27 must realize that there may be two viewpoints on  
28 the cash reserve. In the viewpoint of the  
29 central bank I am sure this is a factor in monetary  
30 control, and presumably the thought would be that





1 monetary control would be better, from the point of  
2 view of the bank. From the point of view of the  
3 inspection officer, these reserves are a factor in  
4 the sound financial condition of the bank.

5 The reduction from a one-month average  
6 to a two-week average would, I would expect, intro-  
7 duce a certain amount of increased rigidity in the  
8 reserve formula, because the shorter the average  
9 the more rigidity is likely to appear.

10 From an administrative point of view,  
11 it is possible without question.

12 THE CHAIRMAN: You do not see any  
13 particular problem from an administrative point of  
14 view?

15 MR. ELDERKIN: I definitely would;  
16 it would present more problems. The longer the  
17 average the easier it is to maintain it, and the  
18 more flexibility you have; the shorter your average  
19 period, the more problems are created. As to how  
20 severe they would be, I think I would rather refer  
21 you to the banks than express an opinion.

22 THE CHAIRMAN: I did not know whether  
23 this was entirely within the scope of your activities  
24 or not.

25 MR. ELDERKIN: Hardly.

26 THE CHAIRMAN: Perhaps this question  
27 may be beyond the scope of your activities. Have  
28 you any views as to the cash level at which the  
29 banks would likely work if they were free of any  
30 minimum requirement?







1 MR. ELDERKIN: You heard evidence  
2 on Friday last that at least one bank thought it  
3 could work to 5 per cent, namely, 2 per cent till  
4 money and 3 per cent clearing balances. This  
5 would of course vary between banks. Some banks  
6 might not be able to work to 2 per cent till money  
7 on an average; indeed, at some times of the year  
8 it would be impossible. In some banks I think the  
9 average runs normally to about 3 per cent.

10 Here, the minimum is important from  
11 monetary control. If you set it to accommodate  
12 the banks which could more easily work to that  
13 minimum, it is entirely possible and in fact  
14 probable that some of the other banks, particularly  
15 the very small ones, could not work to it because  
16 at times they are hit with a very substantial  
17 clearing, and therefore will normally maintain  
18 a higher clearing balance.

19 However, Mr. Brown, I would not want  
20 to put a figure on where this should be set. You  
21 can get this opinion from the different banks as  
22 to where they would prefer to operate.

23 COMMISSIONER MACKINTOSH: Would it  
24 be a fair generalization to say that the lowering  
25 of the minimum ratio would likely be more advantageous  
26 to the large banks than to the small ones?

27 MR. ELDERKIN: I would think so,  
28 Dr. Mackintosh. I would think the large bank is  
29 better able to operate to a lower ratio than a very  
30 small bank. To what degree this would come, in the



1 medium sized banks, I could not suggest at the  
2 present time.

3 COMMISSIONER MACKINTOSH: Thank you.

4 THE CHAIRMAN: At present banks  
5 are not required to hold cash reserves against  
6 foreign currency liabilities in Canada?

7 MR. ELDERKIN: That is right.

8 THE CHAIRMAN: Do you see any danger  
9 in this situation?

10 MR. ELDERKIN: Not as long as they  
11 are covered with reasonable liquid assets in other  
12 countries, and this is the case in the banking system  
13 at the present time.

14 THE CHAIRMAN: Apparently that is in  
15 the reports you receive.

16 MR. ELDERKIN: Yes. This is something  
17 we watch all the time. We get very good reports  
18 on this as to their spot and forward positions.

19 THE CHAIRMAN: So, you don't think  
20 it is necessary to go any further.

21 MR. ELDERKIN: Well, Mr. Chairman,  
22 here again we might get into a situation where the  
23 central bank might feel, for monetary reasons, they  
24 would like some of these reserves to be covered;  
25 but from the point of view of the financial soundness  
26 of the bank, and from the inspection point of view,  
27 it is not necessary.

28 THE CHAIRMAN: Some large share of  
29 foreign currency departments are on a swap basis  
30 with the depositors, and are therefore very close







1 to being Canadian dollar deposits. Should these  
2 deposits be treated differently from the remaining  
3 foreign currency liabilities, with respect to  
4 reserve reporting requirements?

5 MR. ELDERKIN: Here again I think  
6 it is a question of monetary policy rather than one  
7 of the financial soundness of the bank.

8 THE CHAIRMAN: We will adjourn now  
9 until two o'clock.

10  
11 --- Luncheon Adjournment.  
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1 --- Upon resuming at 2:05 p.m.

2  
3 THE CHAIRMAN: Gentlemen, we shall resume.  
4 Mr. Leman, I think you have a question to ask.

5 COMMISSIONER LEMAN: Mr. Elderkin, before  
6 we leave the general subject of the banking business as  
7 a whole, may I say that I gather that in the United  
8 States there is some control over the branch opening  
9 of banks. Is that your understanding?

10 MR. ELDERKIN: That is correct. It varies  
11 from state to state. In some states no branches  
12 whatsoever are permitted. Illinois is an example of  
13 that. In other states a bank may branch within its  
14 own state, or within a measured distance of its head  
15 office. In places where branching is allowed it is  
16 subject to the approval of the state banking authorities.

17 COMMISSIONER LEMAN: Where they have no  
18 objection in principle to branch banking as such --  
19 I gather that in Illinois there is a complete objection  
20 to branch banking.

21 MR. ELDERKIN: That is right.

22 COMMISSIONER LEMAN: Where there is no such  
23 objection, do you know what criteria are used in  
24 approving or disapproving of branch openings?

25 MR. ELDERKIN: Generally, I believe, it is  
26 on the basis of whether there is further need for  
27 banking in that particular community and, perhaps,  
28 as a secondary factor, whether it is going to provide  
29 too much competition for the good of the banks that are  
30 in there at the time.





*Nethercut & Young*

*Toronto, Ontario*

1 COMMISSIONER LEMAN: There have been some  
2 remarks made to us about branch openings in Canada,  
3 and the number of branches we have in certain areas  
4 per head of population, etcetera. Have you any views  
5 as to whether this is controllable or not controllable?

6 MR. ELDERKIN: There is nothing that permits  
7 control at the present time, and I think it would be a  
8 very difficult thing to control. One of the features  
9 that governs this type of legislation in the States,  
10 I think, is the protection of the small bank. If you  
11 allowed a very strong city bank to open a branch in a  
12 smaller community which is now serviced by one or two  
13 smaller banks it might tend to put the smaller banks  
14 out of business in a relatively short time. I think  
15 this has been one of the reasons behind non-branching,  
16 although, in many respects, I think it goes away back  
17 to the days of Andrew Jackson who was determined to  
18 knock down the First Bank of the United States and its  
19 monstrous branch operations as I think he referred to  
20 them.

21 COMMISSIONER MacKEEN: Is that the case  
22 in California?

23 MR. ELDERKIN: No, California permits  
24 branching.

25 COMMISSIONER MacKEEN: But has not the  
26 Bank of California eliminated many of the smaller  
27 banks?

28 MR. ELDERKIN: I think it has. I think it  
29 has bought up many of the smaller banks. I cannot  
30 give you any definite information on that, but there have







1 | been a considerable number of purchases of smaller banks  
2 | in California, and the relative freedom of branching in  
3 | that state may have reduced any thought of starting  
4 | smaller banks.

5 | COMMISSIONER LEMAN: Do you think that  
6 | perhaps there is a relationship between the fact that  
7 | on an average it takes 3 to 5 years in order to get a  
8 | branch as a paying proposition and the number of  
9 | branches that exist?

10 | MR. ELDERKIN: Yes. I think I said earlier  
11 | in my evidence that if a bank was willing to start in  
12 | a very small way and not go in very much for risk  
13 | commercial lending, and was able to obtain deposits  
14 | from the local community, then it could cut down this  
15 | loss period very materially, particularly where it can  
16 | get a high return on its securities. It is my personal  
17 | opinion that any bank of that type would have extremely  
18 | great difficulties in competing with national bank  
19 | branches in the community.

20 | COMMISSIONER LEMAN: I was talking about it  
21 | from a little different point of view. You think there  
22 | is a relationship between the fact that most of our  
23 | communities are not under-serviced with branches and  
24 | the fact that it takes so long to get a branch to be a  
25 | paying proposition, but if a community was under-  
26 | serviced presumably the length of time required to put  
27 | the branch on a paying proposition would be shortened?

28 | MR. ELDERKIN: That is right. In other words,  
29 | what you are saying is because of the competition the  
30 | business is spread out between more than one bank? Yes,





1 that is quite true. This over-banking, if you wish to  
2 use the term, is confined to a great extent, I think,  
3 to the larger cities rather than the smaller communities.

4 COMMISSIONER HARROLD: Mr. Elderkin, I have  
5 a few questions to ask about the present lending powers  
6 of the banks. If the present mortgage prohibition is  
7 removed do you think the banks would expand rapidly  
8 in the provincial mortgage field?

9 MR. ELDERKIN: Mr. Harrold, you heard  
10 opinions that were quite diverse last week from the  
11 presidents', and I do not know whose side I am going to  
12 take in this particular case. This is strictly a  
13 matter of opinion, and I think the opinions were put  
14 forward very clearly. I think there will be a  
15 considerable difference between banks. Some may go  
16 into it more quickly and to a greater extent than  
17 others.

18 I had always pictured this power to a great  
19 extent, although not exclusively, for the convenience  
20 of customers who would be able to have the necessary  
21 security in order to get loans from the banks and who might  
22 not have it if they could not pledge mortgage security.  
23 It is also for the convenience of residents of outlying  
24 districts. I think that the lending under the National  
25 Housing Act extended this type of lending to communities  
26 that could not be reached by any lending authority  
27 except the banks. I know at one stage that a survey  
28 showed that over 50 per cent of the NHA loans made by  
29 the banks were in relatively small communities.

30 COMMISSIONER HARROLD: Do you consider this







1 type of lending -- that is, lending in the conventional  
2 mortgage field -- as a suitable and safe use of bank  
3 funds?

4 MR. ELDERKIN: Yes, under present mortgage  
5 practices I would not say that there is any great  
6 danger. I think you have had this pointed out to you  
7 on many occasions, that lending on residential mortgages  
8 particularly today is a completely different operation  
9 from what it was thirty years ago. Today practically  
10 all the conventional mortgages are on an amortized  
11 basis with monthly, quarterly, semi-annual and, at the  
12 most, annual payments, and most of them run to maturity  
13 in less than ten years.

14 COMMISSIONER HARROLD: I believe you mentioned  
15 in your submission at page 23 that in the United States  
16 they have put some limit on the amount of funds that  
17 any bank is able to put into this type of lending in  
18 total. If this prohibition were removed and some of  
19 the banks proceeded to go into this business in a very  
20 large way would you see the need for any type of  
21 limitation of this kind in Canada?

22 MR. ELDERKIN: No, I would not think so.  
23 Circumstances might change my opinion, but I think  
24 competition would rule very effectively there. If any  
25 bank over-lends in any type of term lending it is  
26 going to be placed in a difficult position when it  
27 comes to supplying its own commercial customers  
28 particularly, and it takes the great risk of losing  
29 some of its commercial customers who can always go  
30 to a bank that is more liquid.





1 COMMISSIONER HARROLD: If this provision and  
2 other provisions were removed to allow the banks more  
3 freedom in the lending field you do not see any  
4 particularly large expansion in the term lending field?

5 MR. ELDERKIN: I think this will depend --  
6 you said "other restrictions" too? You were including  
7 the loan interest rate?

8 COMMISSIONER HARROLD: Yes.

9 MR. ELDERKIN: I think if the loan interest  
10 rate was substantially raised you might have an increase  
11 in term lending. I would expect an increase in term  
12 lending of the mortgage type, perhaps, and some others,  
13 not only in term lending to corporations. There  
14 is a substantial amount of this now, as you will probably  
15 realize, in loans of under \$1 million. Loans of \$1  
16 million and over are considered to be of a type that  
17 should go to the market more than to the banks, and the  
18 banks try to push these on to the market as far as  
19 possible.

20 I think the same reason I gave before that  
21 a bank just cannot afford to reduce its liquidity  
22 beyond a certain level if it is going to be competitive,  
23 applies.

24 COMMISSIONER HARROLD: If we may turn to  
25 the 6 per cent ceiling I notice that at page 25, and at  
26 other sections, you give us some history of how certain  
27 provisions of the Bank Act came about, and how certain  
28 things were done in the banking world. I believe in  
29 paragraph 64 you talk about the normal laws of usury  
30 in Great Britain and Western European countries. I





1 wonder if you could say a word or two about section  
2 91 of the Bank Act. It is a very short section, and  
3 merely states that the ceiling is 6 per cent, which  
4 is now in effect, so far as bank rates are concerned.  
5 There was some change because at one time it was 7 per  
6 cent. Can you add anything more about how this came  
7 about?

8 MR. ELDERKIN: No. As I say in paragraph  
9 62 there was the limitation on interest  
10 rates under the Bank Act ever since Confederation.  
11 The ceiling was 7 per cent, but for a great many years  
12 the only penalty that was enforced in cases where banks  
13 charged more than 7 per cent was that they might lose  
14 the interest which they had charged. It remained at  
15 per cent up until 1944. In 1944 that particular  
16 rate was dropped to 6 per cent. I have never read  
17 any reasons why it was dropped, but one could assume  
18 that it was because interest rates in 1944 were very  
19 low. Long term government bonds were in the 3 per cent  
20 bracket at that time, I think, and probably everybody  
21 -- at least, a great number of people -- thought that  
22 rates would never go up again, and that 6 per cent was  
23 enough.

24 The original reason for it, I would think,  
25 was probably based on the widespread branching of the  
26 banks to keep them within a certain limit in various  
27 geographical areas. I think that some of the proposals  
28 to reduce that rate came from the experience of the west  
29 during the thirties and where, I think, at least some of  
30 the borrowers felt they were paying too much interest in







1 view of the conditions at the time, or in previous times.

2 There is also a factor today, I think, that  
3 was not in effect in 1944 when the rate was reduced  
4 to 6 per cent, in the competition from other lending  
5 bodies, the so-called near-banks. At that time  
6 they were a very minor factor. They were a very minor  
7 factor up until really not too long ago. However, to-  
8 day between the various bodies including the credit  
9 unions and the Caisses populaires there are other  
10 available sources of credit in many cases, and I have  
11 a feeling that no matter what happened all this would  
12 serve to control interest rates pretty well.

13 THE CHAIRMAN: May I ask a question? Do  
14 you have any information as to what was the prime rate  
15 in 1944?

16 MR. ELDERKIN: I might have. Yes, the prime  
17 rate in 1944 was  $4\frac{1}{2}$  per cent.

18 THE CHAIRMAN: And there would be a number  
19 of loans that would be running above 6 per cent in certain  
20 places at that time?

21 MR. ELDERKIN: Yes, where it was an agreed  
22 rate between the borrower and the bank, and where it  
23 came under the 7 per cent limit previously in effect.

24 COMMISSIONER BROWN: Was there a geographical  
25 differentiation in rates at that time? In other words,  
26 were rates in some parts of Canada between 6 and 7 per  
27 cent, and in another parts of Canada over 6 per cent?

28 MR. ELDERKIN: I do not think you can say  
29 so generally. I think that agricultural loans in those  
30 days probably carried a slightly higher rate than other





1 types of loans. If that was the case then it would be  
2 more evident in the prairies than in other places.

3 THE CHAIRMAN: Yes, although in the reports  
4 there was quite a differentiation in rates between the  
5 rates there and the central provinces.

6 MR. ELDERKIN: Not in 1944. Earlier in the  
7 thirties there probably was a substantial differential.  
8 Of course, there was a substantial reason too, namely,  
9 because there were very large losses taken by the banks  
10 on the prairies.in the thirties.

11 COMMISSIONER HARROLD: But even before 1944,  
12 the maximum was 7 per cent.

13 MR. ELDERKIN: Yes, but up until a certain  
14 period the banks charged more than 7 per cent by  
15 agreement between the borrower and the bank, and as long  
16 as the borrower did not afterwards charge the bank with  
17 a violation of the Act it could get the 7 per cent.  
18 There was no penalty to the bank outside of the loss  
19 of the interest. It was prior to 1934, I should have  
20 said, that there was no higher rate recoverable by the  
21 bank, but there was no penalty if the bank did get a  
22 higher rate.

23 COMMISSIONER HARROLD: What would be the  
24 difference today between taking the ceiling off entirely  
25 or raising it to 7 per cent?

26 MR. ELDERKIN: I could not tell you, but I  
27 did mention a while ago that I thought with the present  
28 growing competition from the so-called near-banks there  
29 would be a sort of automatic limit put on it at times.  
30 Where that limit would be would depend, I think, Mr.







1 Harrold, on how far a bank wished to go in taking more  
2 risky loans or, perhaps, in taking longer term loans.  
3 These are the two factors that I think would govern a  
4 higher interest rate in many cases. One other factor  
5 would, of course, be the question of going interest  
6 rates at the present time.

7 We had a similar situation in 1962, when  
8 the banks were up against the ceiling on practically  
9 everything, and there would have been definitely higher  
10 interest rates in 1962 had the ceiling not been there.

11 Where it would stop I do not know, but at that  
12 time you had current rates of interest ranging around  
13 7 and  $7\frac{1}{2}$  per cent.

14 COMMISSIONER HARROLD: One thing that puzzles  
15 me is that when using the term "high interest rates"  
16 and "low interest rates" there does not seem to be a  
17 point at which you can say they are high and another  
18 point at which you can say they are low.

19 MR. ELDERKIN: That puzzles me too.

20 COMMISSIONER HARROLD: They are either high  
21 or low?

22 MR. ELDERKIN: I think it depends upon the  
23 viewpoint of the borrower.

24 THE CHAIRMAN: He thinks they are all too  
25 high.

26 MR. ELDERKIN: Yes.

27 COMMISSIONER HARROLD: You do use the term  
28 here "normal laws of usury". What are those laws?

29 MR. ELDERKIN: I cannot quote from the other  
30 countries, but there is practically no limit within





1 reason, so far as I can ascertain, in European countries  
2 on the rate of interest, and in many of the United States  
3 there is no limit. I remember seeing a Federal Reserve  
4 bulletin showing where interest rates as high as  
5 13 per cent were charged for term or mortgage loans.  
6 They were probably second mortgage loans, but I would  
7 not be sure about this.

8 COMMISSIONER HARROLD: What are your views  
9 on the advantages or disadvantages of the banks  
10 requiring stand-by charges for firm lines of credit?  
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1           If by firm lines of credit you are  
2 referring to the ones in which the bank considers  
3 it is contractually obligated to fill that line  
4 on request, it seems reasonable that the banks should  
5 ask for a stand-by charge on it. They are holding  
6 these funds available for the person on request at  
7 any time. This is a very common practice, as you  
8 may know, in many parts of the United States,  
9 particularly in the New York market. I think it  
10 is usually based on the average non-usage rather  
11 than on maximum non-usage during the period.

12           COMMISSIONER HARROLD: Do you think  
13 a stand-by charge on the unused line of credit would  
14 improve the ability to bring the loan increase  
15 under control?

16           MR. ELDERKIN: I think I would answer  
17 that, Mr. Harrold, by saying that it would make the  
18 borrower very much more careful in establishing his  
19 authorized line of credit, if it is a firm line. If  
20 it is not a firm line the bank still has the power,  
21 if you will, to cut him back within reason if it  
22 is not going to interfere with something that is  
23 essential to the conduct of the business.

24           COMMISSIONER LEMAN: Mr. Elderkin, you  
25 explained this morning that you get reports from the  
26 banks on certain loans they make. Do you get any  
27 information about lines of credit at all?

28           MR. ELDERKIN: Oh, yes, the report includes  
29 the lines of credit. All the individual reports  
30 include the lines of credit, and we get a monthly





1 report, Mr. Leman, not by individual borrowers but by  
2 loan classifications of the amount of authorizations  
3 outstanding and the amount of loans outstanding under  
4 these authorizations. That is one set of statistics  
5 that I furnish to the Bank of Canada, incidentally,  
6 and which appears in the Bulletin.

7 COMMISSIONER HARROLD: There is no legal  
8 limit on the size of a loan to any one customer in  
9 Canada?

10 MR. ELDERKIN: No, not in Canada.

11 COMMISSIONER HARROLD: But there is  
12 in the United States?

13 MR. ELDERKIN: Yes. As a matter of fact,  
14 all national banks in the United States are limited.  
15 The application of any one customer should not be  
16 in excess of 10 per cent of capital and surplus.  
17 I believe that is the definition at the present time.

18 COMMISSIONER HARROLD: Do you see any  
19 need for this kind of thing?

20 MR. ELDERKIN: No. I think we discussed  
21 this this morning, and I do not consider it necessary.  
22 I have never seen any trouble arising from large  
23 loans here. As I mentioned this morning, they  
24 often arise out of pre-issue plans. They are quite  
25 often covered in a reasonably short time anyway.  
26 This is not entirely the case all the time but for  
27 the most part large operating loans are of that nature  
28 or are very seasonable. You might get very large  
29 loans in the retail trade at certain times of the year,  
30 but these are extremely seasonal and pay off in a short



1 period.

2 In United States this 10 per cent limit  
3 has given rise in many cases to what is called a  
4 participation procedure down there. In other words,  
5 a bank will negotiate with a borrower, or vice versa,  
6 for a loan which is far in excess of its authority  
7 to meet. It will then issue to other banks parti-  
8 cipations in that loan and the participations do not  
9 carry the guarantee of the original lending bank.  
10 The new bank coming into the picture takes the same  
11 risk proportionately as the original lending bank.  
12 In many cases the borrower may know that the loan  
13 will be underwritten, if you wish to use that expres-  
14 sion, but perhaps he will not know who will own the  
15 participation certificate, and these can be trans-  
16 ferred.

17 COMMISSIONER HARROLD: What is the Canadian  
18 law and practice regarding the minimum deposit balance  
19 here?

20 MR. ELDERKIN: We have never had it in  
21 Canada. Just as an expression of personal opinion  
22 I cannot see any great advantage to it. I think the  
23 reason for it in the United States, which is the  
24 only place I know of where it is by regulation, is to  
25 protect the smaller bank. It is quite within reason  
26 that in a community where there is a very large bank  
27 and a very small bank the large bank could, if it  
28 wished, push interest rates pretty high on deposits  
29 and make it extremely difficult for the small bank.

30 COMMISSIONER HARROLD: In effect it means







1 a higher interest rate to the borrower, does it not?

2 MR. ELDERKIN: Yes, normally it would  
3 mean a higher interest rate to the borrower. I  
4 suppose the spread depends on what the bank considers  
5 its operating margin should be and how much of their  
6 lending funds interest is being paid to. In our  
7 case we have a mix, of course, of savings and time  
8 and demand deposits and the banks have to take an  
9 average rate over the whole thing in looking at  
10 what they are going to charge on the other side,  
11 in many cases.

12 COMMISSIONER HARROLD: What about deposit  
13 insurance?

14 MR. ELDERKIN: As to the present  
15 institutions under the two Bank Acts, I would say  
16 there was absolutely no need of it. The position  
17 in Canada is quite different from that in the United  
18 States, which is the only country I know of that  
19 has deposit insurance, and where you are dealing  
20 with some 13,000 or 14,000 banks of various sizes,  
21 some of which have only \$50,000 or less in capital.

22 If legislation were expanded to take  
23 in, in one way or another, near banks for which the  
24 federal government -- or even a provincial govern-  
25 ment -- had a responsibility, this would be a situation  
26 which would certainly need exploring.

27 COMMISSIONER HARROLD: For institutions  
28 other than banks?

29 MR. ELDERKIN: Yes. I might say that  
30 you have something of this today in some of the



1 provincial credit unions where in effect they operate  
2 their own deposit insurance. I am referring to the  
3 so-called mutual aid funds where each one pays so  
4 much to a mutual aid fund based on their deposits,  
5 and the deposits of the contributor are insured to  
6 that extent, that is to the extent of the ability  
7 of the fund to pay.

8 COMMISSIONER HARROLD: You said that  
9 this is something which might be explored. Would  
10 you go beyond that and suggest we take a good hard  
11 look at it? I am referring to deposit insurance  
12 for institutions other than banks.

13 MR. ELDERKIN: This, of course, would  
14 depend on government policy. All I can say is that  
15 it can be done. It is done in the United States.  
16 The insured banks in the United States are not all  
17 national banks by any means. Quite a number of  
18 the insured banks in that country are state banks  
19 and there are even some mutual savings banks which  
20 are insured.

21 COMMISSIONER LEMAN: Mr. Elderkin,  
22 your answers indicate you listened carefully to  
23 the evidence given before this Commission by the  
24 banks last week. Presumably when you listened to  
25 that evidence you must have gathered, as we did,  
26 that the chartered banks would rather continue to  
27 run the clearing system themselves. I believe you  
28 heard the argument they put forward in favour of  
29 their doing so. Do you see any advantages or dis-  
30 advantages that may not have come out from the earlier





1 discussion with the banks in having a neutral sort of  
2 body running the clearing system?

3 MR. ELDERKIN: Well, we start off here,  
4 Mr. Leman, asking whether par clearing is an advantageous  
5 thing. Certainly from the point of view of the  
6 customers it is extremely advantageous, and it is  
7 probably desirable if it can be effected. I am not  
8 sure whether you mean here only the clearing of the  
9 banks or whether you are also including in your  
10 question the possibility that other cheque issuing  
11 or order issuing and cashing organizations should  
12 be admitted to the general clearing as well?

13 COMMISSIONER LEMAN: Yes, I meant the  
14 latter because if it was only the clearing of the  
15 banks between banks then I would see no objection  
16 to their continuing to effect it themselves, if  
17 they were the only institutions that needed clearing.

18 MR. ELDERKIN: Well, any full clearing  
19 participant must carry clearing balances, presumably  
20 with the Bank of Canada, although it could be arranged  
21 whereby a member other than a bank, and this is the case  
22 now, may have clearing by a chartered bank. I do  
23 not think it is terribly important and I would not  
24 see any particular advantage in having a neutral  
25 clearing authority. I think the chartered banks  
26 or the Bank of Canada, which is a member of the clearing  
27 house, could operate this.

28 The actual cost of clearing is not  
29 a very major item. The other factors which enter  
30 into this picture are two in number. The first is







1 the cost of float and the second is the cost of what  
2 one might call the paperwork involved. There may  
3 be no cost of float whatsoever in some cases, and  
4 there may be a fairly high one in others. There  
5 will always be the cost of the paperwork.

6 The question here is: should this  
7 be borne by the drawer of the instrument or should  
8 it be borne by the payee? If there is float between  
9 the payee bank and another bank, there is an interest  
10 cost in here provided the payee draws the money  
11 out of the bank when he presents his cheque. There  
12 may not be any cost at all because if he leaves the  
13 money in until it has been covered by the other bank,  
14 there has not been any money in float as such.

15 There is no reason at all why you  
16 cannot operate the present clearing system on a par  
17 basis. It is a question of who is going to absorb  
18 the cost here. In some places in the United  
19 States the payee cannot obtain credit for his  
20 instrument until a value date. That value date may  
21 be one day, two days or maybe three days. They  
22 accept the deposit but they will not allow the person  
23 to draw against it for that period of time.

24 COMMISSIONER LEMAN: The time interval,  
25 the setting of value date, is all under regulation  
26 by the Federal Reserve Board in the United States, is it?

27 MR. ELDERKIN: I cannot answer that.  
28 I am not certain. I think it is determined by the  
29 length of time/<sub>for</sub>the banks in that particular community  
30 to obtain federal funds, and this is easily determined





1 everywhere.

2 One matter that did come out in evidence  
3 which rather surprised me was the question of secrecy,  
4 for I never felt there was any lack of secrecy in  
5 the customers' accounts, in clearing anyway, because  
6 the items are taken to the clearing house in a  
7 bundle for each bank with an itemized list attached  
8 to it. This is where it is cleared, and I do  
9 not think anybody looks at the individual items  
10 at any time. I do not say they could not do so.  
11 I do not say that if you had an independent authority,  
12 or the Bank of Canada authority, they could not tear  
13 a bundle open, but I cannot imagine them doing so.

14 COMMISSIONER LEMAN: In any event,  
15 is it not mostly as between banks that the information  
16 would have any value, if any?

17 MR. ELDERKIN: Oh, yes, and that  
18 could happen today except you would always have a  
19 representative of another bank at the point of  
20 clearing if there was any danger of that? I think  
21 this would happen even if the Bank of Canada were  
22 doing the clearing. You would still have the banks  
23 coming down and presenting their bundles of cheques  
24 to be charged against the other banks.

25 COMMISSIONER LEMAN: So that what  
26 comes out of this operation is whether any one bank  
27 on any one day ends up with a net plus position out  
28 of this particular set of clearing?

29 MR. ELDERKIN: Or a minus position.

30 COMMISSIONER LEMAN: Yes, or a minus





1 position.

2 MR. ELDERKIN: Some nets are bound  
3 to be in it some place.

4 COMMISSIONER LEMAN: May I ask you  
5 whether any institutions other than banks have made  
6 representations to your particular department on  
7 this matter?

8 MR. ELDERKIN: No, not on this  
9 particular matter. At the time the banks adjusted  
10 their charges to some other chequing institutions  
11 there were some protests which came into the depart-  
12 ment against the charges that were being imposed.  
13 The protests were really in the form of, "We don't  
14 know whether this is equitable or not. We don't  
15 know whether we are being overcharged or not."  
16 There was no objection to paying a proper charge if  
17 it was substantiated.

18 COMMISSIONER LEMAN: I gather that  
19 the by-laws and regulations of the clearing system  
20 are subject to the approval of the Treasury Board?

21 MR. ELDERKIN: That is right.

22 COMMISSIONER LEMAN: And presumably  
23 the giving of this approval is based on advice from  
24 your department?

25 MR. ELDERKIN: The only by-laws and  
26 regulations that come up for approval having to do  
27 with the operation of the clearing house involve  
28 hours, vacations, and things like that, and have  
29 nothing to do with the charges that may be made to  
30 an associate member.





1 COMMISSIONER LEMAN: Oh, the charges  
2 are not subject to the approval of the Treasury  
3 Board?

4 MR. ELDERKIN: No, they are not.

5 COMMISSIONER LEMAN: Might it be  
6 desirable that they be so subject?

7 MR. ELDERKIN: You would have to give  
8 me a whole cost accounting staff if you wanted me to  
9 do that.

10 THE CHAIRMAN: You would have room  
11 for it.

12 MR. ELDERKIN: I consider that the  
13 banks have done and are doing a considerable amount  
14 of research along these lines. I do not know what  
15 the results have been, but costing bank operations  
16 is not too simple. I would hate to put a judgment  
17 on it in that respect.

18 COMMISSIONER LEMAN: Would you care  
19 to comment to the Commission about the role of  
20 chartered banks in the underwriting field? Do you  
21 consider that they are institutions which are well  
22 equipped for this function?

23 MR. ELDERKIN: Yes, I think they  
24 have taken a reasonably active part in underwriting.  
25 I would say that this has been almost entirely in  
26 the provincial and major municipal fields, and here  
27 they act as part of an underwriting syndicate and  
28 never, can I recall, as an underwriting manager. This  
29 may have occurred, but I cannot think of any such  
30 occasion at the present time. They do play a very





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1 important part in helping to finance the original  
2 underwriting in some very substantial issues.  
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1 I can see no objection to this; there really is very  
2 little difference in lending on the type of security,  
3 although they may be involved in some profit or some  
4 loss in the final winding up of the syndicate.

5 COMMISSIONER LEMAN: In paragraph 5 of your  
6 submission you cite section 157 of the Act, that  
7 prohibits the use of the name of a bank in a prospectus,  
8 except in any circulars relating to direct and guaranteed  
9 securities of Canada.

10 MR. ELDERKIN: Yes.

11 COMMISSIONER LEMAN: Has this been an  
12 inhibiting factor against banks increasing their  
13 function as underwriters?

14 MR. ELDERKIN: I wouldn't think so. The  
15 reason for this, as you probably know, Mr. Leman, is  
16 that there have been in the past, unfortunately, some  
17 pretty flamboyant advertisements on new issues, in  
18 which the name of the bank might be quite prominent  
19 and in which later on if something happened, the bank  
20 was accused of being a partner in crime, if you will,  
21 and I think that this section was only put in the Act  
22 at the request of the banks themselves to protect  
23 them against any of that sort of danger. I don't  
24 think this has any great effect on the marketability  
25 of an issue at all.

26 COMMISSIONER LEMAN: Do you think it still  
27 serves a useful purpose now that all the provinces  
28 have securities regulations?

29 MR. ELDERKIN: Yes, but all provinces don't  
30 have the same securities regulations by any means.





1 I think it does, yes, because even under the best of  
2 conditions I think that you cannot grade this sort of  
3 thing very well; you either have to prohibit it  
4 altogether or allow almost complete freedom.

5 Perhaps you could stipulate that it shouldn't  
6 be mentioned other than, say, that the banker of the  
7 corporation was bank so-and-so, but this in some people's  
8 minds also conveys that since it is that particular  
9 bank the issuers must be first class citizens, but not  
10 all customers of banks, I suppose, are.

11 COMMISSIONER LEMAN: What I had in mind is  
12 that perhaps now-a-days you trust the banks themselves  
13 to use their own judgment as to when they would  
14 authorize the use of their name.

15 MR. ELDERKIN: Often if there wasn't a  
16 penalty in there the banks would never know and we have  
17 instances -- possibly once a year at least -- in which  
18 this offence has been committed without the knowledge  
19 of the bank.

20 THE CHAIRMAN: Do the banks confine themselves  
21 to government issues as a rule, or do they also under-  
22 write or partially underwrite industrial issues and  
23 other kinds of issues?

24 MR. ELDERKIN: No, I think -- I can't  
25 recall any instances, Mr. Chairman, where they  
26 participated in the underwriting of a corporate issue.

27 THE CHAIRMAN: It is only confined to  
28 provincials?

29 MR. ELDERKIN: And the municipals; certain  
30 high grade or large municipals, where there is







1 an underwriting syndicate, yes.

2 COMMISSIONER LEMAN: Could there, in fact,  
3 arise in certain cases a conflict of interest  
4 if a corporation, for instance, were to borrow in the  
5 long term capital market in order to repay a bank loan?  
6 There is a slight possibility of conflict of interest  
7 there?

8 MR. ELDERKIN: This arises, perhaps, in  
9 another way, too, Mr. Leman; that if a corporation  
10 is borrowing for that purpose, or partially for that  
11 purpose, while the bank may not be a member of the  
12 syndicate, the bank may be approached by the syndicate  
13 to take part of the issue as a means of getting their  
14 loan paid off.

15 COMMISSIONER LEMAN: Repaying themselves!

16 MR. ELDERKIN: Yes, in another form.

17 COMMISSIONER BROWN: Just one point there,  
18 this section of the Act to which Mr. Leman is referring  
19 is section 157(2), and it is almost in two parts, but  
20 it all reads as one part. It says:

21 "Every person other than a bank who uses  
22 the name of a bank in a prospectus or  
23 advertisement for the sale of securities  
24 of any kind other than those issued by  
25 or guaranteed as to principle and interest  
26 by Canada . . . is guilty of an offence  
27 against this Act."

28 And also:

29 "every bank that authorizes its name to  
30 appear".



1 MR. ELDERKIN: That is right, they are two  
2 completely different possibilities; the customer and  
3 the bank.

4 COMMISSIONER BROWN: How about the second  
5 part?

6 MR. ELDERKIN: The second part is a matter  
7 of authorization; if it is done without the bank's  
8 knowledge, the bank has not committed an offence, but  
9 if the bank authorizes the customer to do it, they are  
10 committing an offence.

11 COMMISSIONER BROWN: Might there be a  
12 distinction in your point of view on this in the sense  
13 that the first one the bank has no control over?

14 MR. ELDERKIN: Yes.

15 COMMISSIONER BROWN: And the second one, if  
16 the bank chooses to authorize its name, then the bank  
17 is associated with this particular thing?

18 MR. ELDERKIN: And choosing to violate the  
19 Act.

20 COMMISSIONER BROWN: How about amending the  
21 Act so that it could do it if it so desired? Our banks  
22 are now standing on their own feet and they are pretty  
23 powerful; if they chose to be associated with this  
24 underwriting, does this not answer the first argument  
25 about them being worried about the public associating  
26 their name with it, because they then are making their  
27 choice?

28 MR. ELDERKIN: Yes, but it has always been  
29 the thought, I think, Mr. Brown, that banks should not  
30 be promoting securities other than those of a government



1 account. They may participate in the syndicate which  
2 eventually sells the securities, but they shouldn't  
3 be promoting them themselves.

4 THE CHAIRMAN: Well, what is the real  
5 difference?

6 MR. ELDERKIN: Quite a difference; they may  
7 not sell any of these securities themselves at all.

8 THE CHAIRMAN: If they are assuming a certain  
9 liability?

10 MR. ELDERKIN: Only for the financing. In  
11 other words, if the issue is not sold by the syndicate  
12 they may have to pick up some of the unsold securities  
13 and it may result in a loss. In fact, they may have to  
14 purchase from the syndicate at a fixed price, whereas  
15 the market price has dropped below that.

16 COMMISSIONER BROWN: Every other underwriter  
17 of security by law has to disclose that he is  
18 participating in the underwriting.

19 MR. ELDERKIN: By provincial law?

20 COMMISSIONER BROWN: Yes.

21 MR. ELDERKIN: I don't know.

22 COMMISSIONER BROWN: Why should some  
23 underwriters be excluded from this protection of the  
24 public -- if this is the reason for it, that it is to  
25 protect the public -- why should some underwriters be  
26 excluded from this?

27 MR. ELDERKIN: Again, I think only from the  
28 viewpoint that the banks shouldn't be publicly  
29 sponsoring any corporate security.

30 COMMISSIONER LEMAN: Mr. Elderkin, if we might





1 | turn now to the savings banks.

2 |           COMMISSIONER BROWN: I wonder if we could first  
3 | ask about the hours of business. These minimum hours  
4 | of business are not regulated, as far as I can see, in  
5 | the Bank Act, but they are in the Bills of Exchange Act.

6 |           MR. ELDERKIN: The days of business are  
7 | regulated in the Bills of Exchange Act. There is  
8 | nothing in the Bank Act which compels a bank to be  
9 | open at any particular hour of the day. As far as I  
10 | can find out, the traditional hours of 10 to 3, which  
11 | are normally followed by the banks, are an importation  
12 | from the Scottish banks, which in the early days of  
13 | Canadian banking primarily formed the procedure here.  
14 | I think that these hours are still followed by the  
15 | banks over there -- the 10 to 3 hours -- most of the  
16 | time. As far as the days are concerned, there is really  
17 | nothing in the Bank Act, either, which specifies they  
18 | must stay open every one of the juridical days.

19 |           COMMISSIONER BROWN: Do you think this might  
20 | be included in the Bank Act?

21 |           MR. ELDERKIN: No, I think in some cases this  
22 | has to vary from place to place. For instance, in some  
23 | of the prairie towns or communities, to my knowledge,  
24 | the banks used to stay open on Saturday and close on  
25 | Monday. I don't know if they do now or not, but in  
26 | some places, because of custom, local custom, they opened  
27 | on Saturday and closed on Wednesday, and I think it  
28 | would be very hard to write anything into the Act on  
29 | this.

30 |           COMMISSIONER BROWN: And this is permitted



1 under the Bills of Exchange Act?

2 MR. ELDERKIN: The Bills of Exchange Act  
3 does not require the banks to stay open on these days.  
4 It says that there are statutory holidays on which an  
5 instrument may be payable -- the banks follow the Bills  
6 of Exchange Act, or the custom, but you can't find  
7 anything, I think, in either the Bills of Exchange Act  
8 or the Bank Act which says that a branch of a bank has  
9 to be open on a certain date.

10 COMMISSIONER BROWN: It is my misunder-  
11 standing, because I thought the banks were acting on  
12 the fact that there are certain difficulties that arise,  
13 and particularly with respect, say, to a shopping centre  
14 that closes on Monday, and in the general area this is  
15 not a closing day and you should be able to close on the  
16 same day.

17 MR. ELDERKIN: It does present difficulties  
18 for them in some respects, but they follow the Bills  
19 of Exchange Act except in some special communities.

20 THE CHAIRMAN: They could be open at some  
21 hour convenient to the shopping centre if they want?

22 MR. ELDERKIN: Oh yes. There is nothing to  
23 prevent them. As a matter of fact, I think you have  
24 heard in earlier evidence that the banks have been  
25 experimenting with this in some places.

26 THE CHAIRMAN: Yes.

27 MR. ELDERKIN: And in particular they have  
28 tried out some evening hours and tried out Fridays  
29 from five to seven, I think in some locations, but I  
30 understand from evidence that was given formerly that







1 this hasn't proven very successful, it doesn't seem to  
2 be very effective.

3 COMMISSIONER BROWN: This additional opening?

4 MR. ELDERKIN: Yes.

5 COMMISSIONER BROWN: Isn't there something  
6 in the Bills of Exchange Act about the number of  
7 consecutive days they must not be closed?

8 MR. ELDERKIN: No, there is not; there is  
9 a misconception in the minds of many people that the  
10 banks cannot stay closed for more than three consecutive  
11 days, and this I think comes from the "days of grace"  
12 provision in the Bills of Exchange Act, but actually  
13 there is no such provision. There is nothing in the  
14 Bills of Exchange Act that I know of that says a bank  
15 has to stay open on any particular day.

16 THE CHAIRMAN: Or stay closed for a week?

17 MR. ELDERKIN: Really, there is nothing to  
18 stop them, but the bank might soon get in great trouble  
19 if they weren't ready to meet their customers' payments.

20 THE CHAIRMAN: They would lose some  
21 business.

22 MR. ELDERKIN: Definitely, and the reason  
23 that the Bills of Exchange Act governs bank operations  
24 to a great extent is that this would give rise to  
25 very serious inconvenience if the bank was not open on  
26 the day that a bill came due and payable.

27 COMMISSIONER LEMAN: Turning now to the  
28 Quebec Savings Banks, Mr. Elderkin, I would like to  
29 ask you a very broad question: why have a special Act  
30 for them?



1 MR. ELDERKIN: Well, savings banks all over  
2 the world have special acts. Savings banks are normally  
3 restricted in their activities, in their investment  
4 and activities particularly, /in as far as commercial lending  
5 is concerned.

6 For the last ten or twelve years -- well,  
7 ever since 1948 we have been relaxing these restrictions  
8 on the Quebec savings banks. We have had four amendments  
9 to the Quebec Savings Banks Act in that period, all of  
10 which were for the purpose of relaxing the restrictions  
11 and giving them more powers, but still not powers to  
12 carry out commercial lending, and I don't think they  
13 want these powers as a matter of fact; I have never  
14 heard any expression from them that they would like to  
15 have them.

16 You could have the same Act with two parts, Mr.  
17 Leman, if you wanted to, because some of the provisions  
18 in the Bank Act, of course, are analagous with the  
19 Quebec Savings Bank Act, and you try to put as many of  
20 these on the same basis as possible, and we did this  
21 in 1954, but here again you have another situation  
22 which I mentioned earlier, that here you have an  
23 incorporated body with all the powers of an incorporated  
24 body, as compared with a statutory body, which the banks  
25 are. They are two different types in law.

26 Now, we can get around that, of course, very  
27 easily, in the same way we got around -- our past bank  
28 legislation got around this point by cancelling the  
29 charters by law and making the Act the charter of the  
30 banks. This can be done if it was found advisable to





1 do it, but it is so close to it now that it might as  
2 well do that because they can't do anything outside of  
3 the Act.

4 COMMISSIONER LEMAN: No longer does it make  
5 any practical difference?

6 MR. ELDERKIN: None, actually.

7 COMMISSIONER LEMAN: Well now, if the  
8 legislature should contemplate broadening the powers of  
9 the chartered banks to take mortgage securities -- and  
10 the savings banks have that power now, to take mortgage  
11 securities -- what would be the objection to letting  
12 the savings banks indulge in commercial lending?

13 MR. ELDERKIN: Well, you are dealing here with  
14 a different class of deposit, for one thing, to a great  
15 extent, although we admit that the savings banks in the  
16 province of Quebec differ from savings banks in most  
17 other places because they practically operate demand  
18 accounts. While they have the regulations which permit  
19 them to defer payment of an account, this is never  
20 practiced and so their savings accounts are practically  
21 demand accounts. They have practically no demand  
22 accounts as such, -- I will put it another way around --  
23 interest bearing accounts, but <sup>few</sup> non-interest bearing  
24 accounts.

25 I have never heard that they would like to  
26 take on commercial lending, and I think I should answer  
27 that by saying that they have no trained staff for that  
28 purpose.

29 Now, if they were permitted to do so they  
30 could, and they would have the know-how over a period of







1 time, no doubt, to build up a commercial lending staff,  
2 but today they have nobody in their organization who  
3 had any experience to speak of along those lines. They  
4 have never shown any interest in it, and that is another  
5 thing.

6 The savings banks, as you realize if you  
7 look at their statements over the last ten years  
8 particularly, have been tending -- with the benefit of  
9 legislation -- to invest more and more in mortgages and  
10 particularly in conventional mortgages; one of the banks  
11 carries some NHA mortgages and the other one does not.  
12 That and medium term securities are their principal  
13 investments.



1                   COMMISSIONER LEMAN: I do not have all  
2 these points in my mind now, but I went over them  
3 a few months ago, and it seemed to me that there  
4 were quite a few limitations on their investments.

5                   MR. ELDERKIN: Yes, there are.  
6 For instance, there is a limitation on corporate  
7 stocks, and on certain types of securities that do  
8 not have a good earnings record. In that Act,  
9 I think it is Section 59A, there is a provision  
10 which is very similar to the so-called basket clause  
11 in the Insurance Companies Act, in which they are  
12 allowed to invest in anything they want to up to  
13 a certain percentage. In the Insurance Companies  
14 Act, if I remember correctly, it is 3 per cent of  
15 assets. Here we measure it more by the capital  
16 funds - it is 50 per cent of the capital funds. The  
17 theory behind that is probably that they are risking  
18 capital funds and not the depositors funds, when you  
19 get into that type of investment.

20                   This has been used to some extent -  
21 not as greatly as one might expect in some cases.  
22 However, in their submission to you I think they  
23 asked for extended powers. One was to include public  
24 utilities securities in what we term the free list,  
25 in which they can invest as much as they want, rather  
26 than the restricted list where they are held to  
27 a certain percentage of deposits.

28                   This is not unreasonable and certainly  
29 would receive consideration in the revision of the Act.

30                   They have asked for an amendment which







1 would increase the amount of their present unsecured  
2 loans from 5 per cent of deposits to 10 per cent  
3 of the deposits, and in the case of an individual  
4 loan from \$5,000 to \$10,000. The history of this  
5 is rather interesting. We started off in 1948 with  
6 unsecured loans at \$1,000; in 1954 we moved up to  
7 \$2,000; in 1957 we moved to \$5,000, and now they  
8 want \$10,000. I don't know where it stops. How-  
9 ever, these suggestions will all receive serious  
10 consideration at the next revision, because they  
11 are not outside the bounds of reason with these two  
12 banks, both of which have over 100 years experience  
13 behind them.

14 Some of this legislation probably  
15 has the viewpoint of savings bank legislation in  
16 other countries which have to deal with many small  
17 types of savings banks with probably not very competent  
18 management in some cases. Here we have two banks,  
19 both of which have a long period of operation and  
20 experience behind them. If we are looking at those  
21 two alone, I think we can take a much more lenient  
22 view than we can with possibly a new institution  
23 which might come in.

24 COMMISSIONER LEMAN: Although the  
25 Act as it now stands does not open the door to  
26 the incorporation of a new savings bank.

27 MR. ELDERKIN: No, but this could  
28 be done in the manner I mentioned a minute ago, namely,  
29 by cancelling the charters here and putting them into  
30 the statutory position. Then all they would need would





1 be a special act of parliament, the same as we now  
2 have for chartered banks, which would spell out their  
3 incorporation and immediately throw them into the  
4 Savings Bank Act.

5 We are almost there now in every other  
6 respect. Personally, I think the only reason we  
7 did not provide that type of Act in 1954 was because  
8 some people in the savings bank group did not want  
9 to move that quickly.

10 COMMISSIONER LEMAN: The last time  
11 there were revisions made, was there any suggestion  
12 on the part of anyone that the limitation on the age  
13 of directors should be the same as for chartered  
14 banks?

15 MR. ELDERKIN: I would have to be  
16 very careful in answering that question. You probably  
17 would not expect the general manager of a bank to  
18 say, "I wish my directors over the age of 75 years  
19 were not allowed to sit any longer". Let us put  
20 it in the reverse position. I have been asked  
21 on many occasions why we did not put the same pro-  
22 vision in the Savings Act. Once again, we did not  
23 consider it quite necessary -- that is, parliament  
24 didn't consider it necessary -- and it was not the  
25 unanimous wish expressed by the two banks.

26 COMMISSIONER LEMAN: Offhand, if  
27 there is logic in the provision in the Bank Act,  
28 there would seem to be about the same amount of  
29 logic there.

30 MR. ELDERKIN: Not quite, Mr. Leman.





1 One of the difficulties encountered in a directorate  
2 under the Bank Act is the access to individual  
3 commercial borrowers' accounts which may come before  
4 the board, and you have to take the extreme view. For  
5 instance, a director who got to the point where he  
6 was not mentally competent and was inclined to  
7 talk about bank affairs outside the directors meetings,  
8 could cause very serious trouble. The same danger  
9 does not exist in the savings banks.

10 You can also say that the 75 year  
11 limit has deprived the banks of some very competent  
12 and clever people. But probably in the long run  
13 it can be regarded by the banks as a very good measure  
14 under all the circumstances.

15 THE CHAIRMAN: It is rather awkward  
16 when the directors all reach 75 years at the same  
17 time.

18 MR. ELDERKIN: You mean when they go  
19 to sleep in directors meetings?

20 THE CHAIRMAN: Who is going to fire  
21 whom?

22 MR. ELDERKIN: Perhaps it is human  
23 nature, but very rarely do they want to resign.

24 THE CHAIRMAN: Nobody ever wants to  
25 resign.

26 COMMISSIONER LEMAN: Did not the  
27 Quebec Savings Bank<sup>s</sup> also make a request relating to  
28 the percentage to be lowered on mortgages?

29 MR. ELDERKIN: Yes, they wanted an  
30 increase in this. There again, we -- I am using







1 the editorial "we" -- parliament has put a gradual  
2 increase in the limits, which now are at 40 per cent  
3 of the deposits covering both N.H.A. and conventional  
4 lending mortgages. I think they want the N.H.A.  
5 mortgage eliminated from any limit, and the conventional  
6 mortgage limit raised to -- I have forgotten their  
7 request in this respect.

8 This is all a matter of evolution  
9 and training. Frankly, the thought behind this  
10 was to work them gradually into these positions, as  
11 they acquired experience. Here I may say that their  
12 experience in mortgage lending has been extremely  
13 satisfactory. In the conventional field, losses  
14 are negligible.

15 COMMISSIONER LEMAN: We have heard  
16 a request from the chartered banks that they be  
17 empowered to lend against mortgage security. But  
18 nowhere was there any discussion as to whether there  
19 should be some percentage limitations in the way in  
20 which they could lend against mortgages. Does that  
21 inspire any comment on your part?

22 MR. ELDERKIN: Yes, Mr. Leman. I  
23 think I could say this is a question of liquidity  
24 to a great extent. In commercial banks the need is for  
25 liquidation to meet the demand for commercial loans.  
26 If a bank cannot discipline itself and manage its  
27 own affairs in that respect, it is going to get  
28 itself into trouble. I do not mean that it will  
29 get into financial trouble, but it will lose its place  
30 in the competitive field of commercial lending.



1 With savings banks there is no such  
2 demand. There is no great surge of demand. There  
3 is a demand for loans-- a fairly controllable demand.  
4 They don't have long-term loans, except in the  
5 mortgage field. They have call loans or personal  
6 loans, and all of these are very easily managed.  
7 Their liquidity demands are quite different from  
8 those of the commercial banks.

9 This is one reason why we have a  
10 different cash reserve for them. The Quebec  
11 Savings Banks have a 5 per cent daily reserve as  
12 compared with an 8 per cent average reserve for  
13 chartered banks. The impact of their clearings  
14 is not as heavy by any means, relatively speaking,  
15 as that of the chartered banks.

16 COMMISSIONER LEMAN: In the mortgage  
17 fields, I had in mind the competitive angle. If a  
18 lot of mortgage lending institutions are subjected  
19 to either statutory or conventional limitations or  
20 on a percentage of loans against security, et cetera,  
21 and the banks did not have it, that might affect  
22 the relative competitive freedom which each type  
23 of institution had.

24 MR. ELDERKIN: It is certainly  
25 going to affect the relative position on interest  
26 rates that may be charged too. That is, the more  
27 competition there is to get into this conventional  
28 mortgage field, the more competitive the rates are.  
29 I don't think this is going to impose a particular  
30 onus as far as the comparison between commercial banks





1 and savings banks goes, for the reason I have tried  
2 to explain. The commercial banks cannot afford to  
3 go beyond a certain stage in their long-term lending,  
4 whereas the savings banks can go up to their statutory  
5 limit or even higher, because of the semi-permanence  
6 of their deposits. It is perfectly true that these  
7 are payable by arrangement on demand, but if you look  
8 at the history there / <sup>is a</sup> solid body of deposits, and  
9 the way it is growing in both organizations at the  
10 present time, it is apparent that the global amount  
11 does not go down except very temporarily.

12 COMMISSIONER LEMAN: How about these  
13 institutions limiting their loans on properties to  
14 60 per cent of the value of the property? I admit  
15 there is always the matter of valuation, that there  
16 is a certain freedom in the way in which valuation  
17 is placed on a property.

18 MR. ELDERKIN: Yes.

19 COMMISSIONER LEMAN: We have been told  
20 that there are criteria, and it is fairly uniform  
21 among institutions; it may vary a little, but generally  
22 speaking the valuation procedures are not too different.  
23 Do you see any merit in any regulations of this sort?

24 MR. ELDERKIN: Well, possibly the  
25 maximum which is set by the Act at the present time  
26 is somewhat antiquated in that no doubt it was set  
27 when there was a completely different method of  
28 mortgage payments than there is today. It was  
29 set at a time when a mortgage term was for five or  
30 ten years, with no arrangement for repayment. There-



1 fore, these institutions and other companies considered  
2 that there should be a relatively low level of  
3 valuation.

4 There is a considerably higher  
5 level of valuation in the savings banks, in many  
6 of the states, where they can run up to 75 per cent.  
7 I think I am right in saying that the Saxon Report  
8 mentions this for commercial banks -- 75 to 80 per  
9 cent of valuation, provided the mortgage is repayable  
10 in instalments over a reasonable period of time.

11 I think this is something that the  
12 government will be looking at very definitely when  
13 it comes up in 1964.

14 COMMISSIONER LEMAN: That is all I  
15 have, Mr. Chairman.

16 COMMISSIONER BROWN: I would like  
17 to ask Mr. Elderkin about inner reserves of the  
18 Quebec Savings Banks. The basis of calculation is  
19 on a higher level than that permitted for the  
20 commercial chartered banks.

21 MR. ELDERKIN: Yes. Here again,  
22 Mr. Brown, they are now not permitted any reserves  
23 on Government of Canada securities or provincial  
24 securities, but they are allowed at the present time  
25 a 5 per cent reserve on most of their loans, a large  
26 percentage of which really falls in the mortgage class.

27 This has been in effect ever since  
28 1944, and I think it has been left in effect to see  
29 what experience the banks will have in mortgages.  
30 They were never in the mortgage field prior to that





1 | time; their investments were almost entirely in  
2 | securities and call loans, et cetera. It was  
3 | only later that they got authorization to make  
4 | conventional mortgage loans, and the government up to  
5 | the present time has permitted them to have  
6 | this 5 per cent reserve. I cannot tell what their  
7 | viewpoint will be at the next revision. There is  
8 | no formula here, and I do not think you could put  
9 | a formula on the savings banks. This is a completely  
10 | different story; we are dealing with a type of  
11 | assets where there is no lengthy history at all.

12 | COMMISSIONER BROWN: Is this a  
13 | suggestion that if the banks go in to conventional  
14 | mortgage lending that their reserve basis of cal-  
15 | culation should be varied too?

16 | MR. ELDERKIN: No, I don't think so.  
17 | They already have some mortgages, and they have some  
18 | near mortgages. - a great number of them, in the  
19 | way of corporate bonds.

20 | COMMISSIONER BROWN: I notice there  
21 | is another distinction too, that if a Quebec Savings  
22 | Bank goes over the par, they have only to take one-  
23 | fifteenth for the year, and if they go below they  
24 | can make it all up in any one year.

25 | MR. ELDERKIN: Yes. This is the  
26 | same provision as in the formula for the chartered  
27 | banks up to 1960. There is very little variation  
28 | outside of the growth in the assets of the savings  
29 | banks. I think this is about the only reason I  
30 | can suggest that this particular provision has not





1 been taken out of the formula so far as the savings  
2 banks are concerned.

3 COMMISSIONER BROWN: It has not  
4 been operative.

5 MR. ELDERKIN: It has not been  
6 operative because they have been growing anyway. It  
7 could be changed any time on the Minister's  
8 instructions.

9 COMMISSIONER BROWN: I was trying  
10 to get the basis or the principle behind this  
11 method of calculation and of handling this problem  
12 or of putting over the formula.

13 MR. ELDERKIN: Yes.

14 COMMISSIONER BROWN: That is all,  
15 Mr. Chairman.

16 THE CHAIRMAN: Thank you very much,  
17 Mr. Elderkin.

18 MR. ELDERKIN: Thank you. I hope  
19 I have been of some help.

20 THE CHAIRMAN: It has been a very  
21 useful discussion.

22 We shall now adjourn until 9.15  
23 tomorrow morning when we shall hear the submission  
24 of the Industrial Development Bank.

25  
26  
27 --- Adjournment.  
28  
29  
30



# Royal Commission on Banking and Finance

INSPECTOR GENERAL of BANKS.

Hearings  
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SUBMISSION

to the

ROYAL COMMISSION ON BANKING AND FINANCE

with respect to

THE BANK ACT

Chapter 48 of the Statutes of Canada, 1954

(Pages A. A1 to A. 56 following)

and

THE QUEBEC SAVINGS BANKS ACT

Chapter 41 of the Statutes of Canada, 1954

Amended by Chapter 12 of the Statutes, 1956-57

(Pages A. 58 to A. 88 following)

DEPARTMENT OF FINANCE,

OTTAWA, May, 1962.

C. F. ELDERKIN,

Inspector General of Banks.





THE BANK ACT

Comments on some of its more important features  
and information regarding legislation on similar  
matters in some other countries.

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## HISTORY

1. Section 91 of the British North America Act provides that the exclusive legislative authority of the Parliament of Canada extends inter alia, to all matters coming within the head of Banking, Incorporation of banks and the Issue of paper money. In 1867 and again in 1870 Parliament continued the charters of the banks then operating in the four provinces entering Confederation and in 1871 enacted "An Act relating to banks and banking". The Act became the charters of all the banks and continued them to July 1, 1881, thus establishing them as statutory corporations, which they are today. It was intended that there should be a decennial revision of the Act and this has taken place except on three occasions when one year extensions were granted.

2. The first bank charter was granted by the old Province of Canada in 1822 and between then and July 1, 1867, 80 banks were created in what is now Canada of which 35 charters were in effect at the latter date. Since then 77 charters have been granted. Of these 112 charters, 38 however were never used and expired. Of the 74 banks which commenced business, 28 failed and 38 have disappeared through mergers or amalgamations. Only one of the 8 banks now active was incorporated within the past ninety years.

3. While the British North America Act assigns to the Parliament of Canada exclusive authority to legislate on "banking" and the "incorporation of banks", it does not define the terms. There have







1    been many legal cases in which the terms "banks" and  
2    "banking" have been considered but insofar as known,  
3    no precise definition appears in the statutes of any  
4    country. Some, that have the constitutional authority  
5    to do so, have enacted legislation governing all  
6    "credit institutions" carrying on business in the  
7    country and have included "banks" within this group.

8    4.            A summary of some definitions and legal  
9    opinions on this subject is submitted as an Appendix,  
10   pages A.46 to A.52.

11   5.            The only governing legislation in the  
12   statutes of the Canadian Parliament is contained in  
13   section 157 of the Bank Act, reading as follows:

14        "157. (1) Every person who, in any language,  
15        uses the word 'bank', 'banker' or 'banking',  
16        either alone or in combination with other  
17        words, or any word or words of import  
18        equivalent thereto, to indicate or describe  
19        his business in Canada or any part of his  
20        business in Canada without being authorized  
21        so to do by this or any other Act, is guilty  
22        of an offence against this Act.

23  
24        (2) Every person other than a bank who  
25        uses the name of a bank in a prospectus or  
26        advertisement for the sale of securities of any  
27        kind other than those issued by or guaranteed  
28        as to principal and interest by Canada, and  
29        every bank that authorizes its name to appear  
30        in such a prospectus or advertisement or uses





1 its name in such a prospectus or advertisement  
2 published in a newspaper, is guilty of an  
3 offence against this Act."

4 6. The provision in subsection (1) has the  
5 effect of prohibiting any foreign bank from operating  
6 a branch or agency in Canada under its own name  
7 if the name includes any of the words reserved to  
8 the authority of Parliament.

9 INCORPORATION OF BANKS

10 7. Sections 8 to 18 of the Act contain the  
11 provisions governing the incorporation of a bank  
12 which requires a special Act of Parliament. On the  
13 coming into force of the incorporating Act, the Bank  
14 Act becomes the charter of the bank and it has  
15 conferred upon it all the powers and is subject to  
16 all the provisions of that Act. As a statutory  
17 corporation it has no powers other than those in its  
18 charter and if any unauthorized action was taken, it  
19 would be void.

20 DIRECTORS

21 8. The Act provides that the bank shall be  
22 under the management of a board of directors of whom  
23 a majority must be subjects of Her Majesty ordin-  
24 arily resident in Canada.

25  
26 9. Directors are elected by the shareholders  
27 at each annual general meeting and if a vacancy occurs  
28 during the year, it may be filled by the remaining  
29 members of the board. A person is not eligible to  
30 be elected or appointed a director if he has reached







1 the age of seventy-five years.

2 10. Directors may make by-laws with respect  
3 to any matter except an increase in their own  
4 remuneration but where any such by-law provides for  
5 a matter that may be the subject of a shareholders'  
6 by-law, it must be ratified at the next annual  
7 general meeting or thereafter cease to have effect.

8  
9 CAPITAL ACCOUNTS

10 11. Since the Bank Act was amended in 1954  
11 there have been substantial increases in the total  
12 of paid-up capital and rest accounts of all banks.

13 The Bank Act provides that

- 14 (1) The authorized capital of a bank must be  
15 stated in the original charter and must not  
16 be less than \$1 million divided into shares  
17 of \$10 par value each.
- 18 (2) The subscribed capital must be not less than  
19 \$1 million and the paid-up capital not less  
20 than \$500,000.
- 21 (3) The authorized capital may be increased by  
22 means of a shareholders' by-law if the latter  
23 is approved by the Treasury Board.
- 24 (4) The directors may issue new shares within  
25 the limits of the authorized capital and  
26 these shares must first be offered to the  
27 then shareholders on a pro rata basis  
28 except that
- 29 (a) the price of the shares shall be not  
30 less than the par value of \$10 each





1 and any premium no greater in relation  
2 to the par value than the rest account  
3 is in relation to the paid-up capital  
4 stock,  
5 and

6 (b) no shares need be offered to a resident  
7 of a country where the offer should not  
8 be made unless information other than that  
9 in the last financial statement is  
10 required.

11 (5) The bank has an option with respect to the  
12 type of shares to be issued. These may be  
13 transferable only on the stock registers of  
14 the bank or they may be transferable without  
15 registration. Five of the eight banks have  
16 shares of the latter type.

17 Capital Funds versus Loans and Investments

18 12. There is no statutory measurement in the  
19 Bank Act relating the amount of the paid-up capital  
20 to the maximum investment in any type of assets, such  
21 as loans, securities or bank premises. National banks  
22 in the United States, subject to a number of  
23 exceptions, may not hold total obligations of any  
24 borrower in excess of an amount equal to ten percent  
25 of the paid-up capital and surplus of the bank. The  
26 total of investment in bank premises and controlled  
27 realty corporations and loans to the latter may not  
28 exceed an amount equal to the paid-up capital. A  
29 state bank which is a member of the Federal Reserve  
30 system has the same limitations on investment as a





1 national bank.

2 13. Banks in Great Britain have no statutory  
3 limitation on holdings of any asset. The laws of  
4 several other European countries that were examined  
5 do not require any prescribed relationship between  
6 capital and assets of the banks. Australia has no  
7 limitations on holdings of any asset.

8 Par Value of Shares

9 14. Bank shares in Great Britain must have a  
10 par value, usually, of £1 each. United States  
11 national bank shares must have a par value of \$100  
12 each or such lesser amount as may be provided by the  
13 articles of incorporation and preferred stock may be  
14 issued if approved by the Comptroller of the Currency.

15 Minimum Capital Stock

16 15. Banks in Great Britain operate under  
17 the Companies Act and no minimum capital is required.  
18 National banks in the United States are required to  
19 have a paid-up capital of \$50,000 to \$200,000 depending  
20 on the size of the community.

21 Maximum Capital Stock

22 16. The laws of Great Britain do not state  
23 any maximum but an increase in authorized capital  
24 would require an amendment to the charter of a bank.  
25 United States national banks require the approval of  
26 the Comptroller of the Currency to increase authorized  
27 capital. A European bank requires an amendment to  
28 its charter to increase its authorized capital.

29 Increases in Paid-up Capital and Rest

30 17. On page A.8 following there is submitted







1 a statement of additions to paid-up capital and rest  
2 accounts of the chartered banks.

3 Comparison with United States Insured Commercial Banks

4 18. On page A.9 following there is submitted  
5 an approximate percentage comparison as at December  
6 31, 1960 of the assets, liabilities and capital  
7 accounts of Canadian chartered and United States  
8 insured commercial banks.





STATEMENT OF ADDITIONS BY BANKS TO REST ACCOUNT  
AND PAID-UP CAPITAL DURING THE YEARS 1954 TO 1961  
AND TOTALS FOR PRIOR YEARS

(Amounts in thousands of dollars)

	Rest Account			Paid-up Capital
	From Profits <sup>1</sup>	From Issue of Capital Stock	Total	
Bank of Montreal	35,000	50,850	85,850	24,750
The Bank of Nova Scotia	20,520	36,480	57,000	12,000
The Toronto- <sup>2</sup> Dominion Bank	19,400	34,647	54,047	16,943
The Provincial Bank of Canada	6,200	2,800	9,000	2,000
Canadian <sup>3</sup> Imperial Bank of Commerce	69,570	60,430	130,000	29,680
The Royal Bank of Canada	85,460	82,611	168,071	31,528
Banque Canadienne Nationale	17,000	9,000	26,000	3,000
The Mercantile Bank of Canada	<u>600</u>	<u>400</u>	<u>1,000</u>	<u>4,000</u>
All banks, 1954-1961	253,750	277,218	530,968	123,901
All banks, prior years	<u>138,510</u>	<u>116,490</u>	<u>255,000</u>	<u>151,000</u>
Totals	<u>392,260</u>	<u>393,708</u>	<u>785,968</u>	<u>274,901</u>

Notes 1 Including re-transfers from inner reserves.

2 Including figures of The Bank of Toronto and  
The Dominion Bank prior to amalgamation.

3 Including figures of The Canadian Bank of  
Commerce, Imperial Bank of Canada and Barclays  
Bank (Canada) prior to amalgamations.







APPROXIMATE ASSET AND LIABILITY PERCENTAGES  
AT DECEMBER 31, 1960  
CHARTERED BANKS AND U.S. INSURED COMMERCIAL BANKS

	<u>Canada</u>	<u>United<sup>1</sup> States</u>
	<u>%</u>	<u>%</u>
<u>Assets</u>		
Cash assets and due from banks	14.4	20.3
Federal government securities	18.1	23.6
Provincial or State and municipal securities	5.8	6.8
Other securities	3.4	1.2
Loans and discounts	55.0	45.8
Bank premises and controlled corporations	1.7	1.1
All other assets	<u>1.6</u>	<u>1.2</u>
	<u>100.0</u>	<u>100.0</u>
<u>Liabilities</u>		
Federal government deposits	3.0	2.4
Deposits and balances due other banks	5.0	7.3
Demand deposits, other	38.0	51.8
Time and savings deposits, other	46.1	27.8
All other liabilities	2.0	2.6
Capital funds	<u>5.9</u>	<u>8.1</u>
	<u>100.0</u>	<u>100.0</u>

1 Source: Annual report of the Deposit Insurance Corporation for the year ended December 31, 1960. Figures are adjusted in some cases to fit Canadian titles.



FINANCIAL STATEMENTS

19. Section 58 which deals with the annual financial statements which the bank must submit to its shareholders was almost completely revised in 1954 to conform with modern accounting procedure. Section 103 requires the bank to submit monthly statements of assets and liabilities to the Minister of Finance and these are published in the Canada Gazette. The forms of the statements of assets and liabilities which appear as Schedule N and M respectively in the Act were amended by the Governor in Council in January 1957 to require the banks to state all securities of the governments of Canada and the provinces at amortized value. Other securities are stated at not more than market value in the annual and monthly reports.

20. A review of the annual financial statements of banks in other countries indicates that those of the Canadian banks compare favourably as to detail and information. There appears to be no similar requirement elsewhere to compare with the very comprehensive monthly return of assets and liabilities of individual banks submitted and published here.

21. It is not a requirement here or elsewhere to publish a detailed statement of earnings and expenses of individual banks, but a composite statement for all chartered banks is tabled in Parliament and published annually in the Canada Gazette. A copy of this statement for the fiscal





1 years ended in 1961 appears on page A.12'Following. An  
2 approximate percentage comparison of earnings and  
3 expenses of the Canadian chartered banks and the  
4 United States insured commercial banks for 1960 is  
5 submitted on page A.13 following.  
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**THE CHARTERED BANKS OF CANADA**  
**EARNINGS, EXPENSES AND OTHER INFORMATION**  
**FOR THE FINANCIAL YEARS ENDING IN 1961**

(Dollar amounts in millions)

Compiled from returns made pursuant to section 106 of the Bank Act

<b>CURRENT OPERATING EARNINGS</b>	<b>\$</b>
Interest and discount on loans.....	540.5
Interest, dividends and trading profits on securities <sup>1</sup> .....	196.6
Exchange, commission, service charges and other current operating earnings.....	143.1
<b>Total current operating earnings.....</b>	<b>880.2</b>
<b>CURRENT OPERATING EXPENSES</b>	
Interest on deposits.....	290.8
Remuneration to employees.....	243.8
Contribution to pension funds.....	13.3
Provision for depreciation of bank premises.....	19.6
Other current operating expenses.....	122.8
<b>Total current operating expenses.....</b>	<b>690.3</b>
<b>Net current operating earnings<sup>2</sup>.....</b>	<b>189.9</b>
Add: Capital profits and non-recurring items <sup>3</sup> .....	1.5
Add: Retransfers from inner reserves less provision for losses <sup>4</sup> .....	10.6
Less: Provision for income taxes <sup>5</sup> .....	101.7
<b>Leaving for dividends and shareholders equity.....</b>	<b>100.3</b>
Of which: Dividends to shareholders.....	57.8
Additions to shareholders equity.....	42.5

**ADDITIONS TO SHAREHOLDERS EQUITY AND INNER RESERVES**  
**TWENTY-FIVE FINANCIAL YEARS ENDING IN 1961**

<b>SHAREHOLDERS EQUITY</b>	<b>\$</b>
Undivided Profits	
From operating earnings, net after transfers to rest account.....	1.4
Rest Account	
From operating earnings and undivided profits.....	160.2
From retransfers from inner reserves.....	206.8
From premium on new shares.....	285.2
Capital Paid Up	
From issue of new shares.....	129.4
<b>Net addition to shareholders equity.....</b>	<b>783.0</b>
<b>INNER RESERVES</b>	
From operating earnings and capital profits.....	572.9
Less: Amount retransferred to rest account.....	206.8
Less: Losses on loans and investments <sup>1, 6, *</sup> .....	161.0
<b>Net addition to inner reserves.....</b>	<b>205.1</b>
<b>*Ratio of average annual loss experience to related assets.....</b>	<b>.151%</b>

**NOTES**

<sup>1</sup> Realized profits and losses on disposal of securities are included in operating earnings.

<sup>2</sup> Before provision for income taxes, losses and transfers to inner reserves.

<sup>3</sup> Profits and losses on sale of fixed assets and adjustments relating to prior years.

<sup>4</sup> After amounts retransferred to rest account.

<sup>5</sup> Includes income taxes on taxable portion of additions to and amounts retransferred from inner reserves, and foreign taxes.

<sup>6</sup> Losses and provision for losses on loans and provision for market valuation of investments other than securities of Canada and the provinces, less recoveries.

OTTAWA,  
 February 1, 1962.

K. W. TAYLOR,  
*Deputy Minister of Finance.*



APPROXIMATE EARNINGS AND EXPENSES PERCENTAGES  
CHARTERED BANKS AND U.S. INSURED COMMERCIAL BANKSCANADA - FISCAL YEARS 1960 : U.S. - CALENDAR YEAR 1960

	<u>Canada</u>	<u>United</u>
	<u>%</u>	<u>States</u>
<u>Earnings</u>		
Interest and discount on loans	62.4	62.8
Interest, dividends, trading profits on securities	21.6	22.9
Other operating earnings	<u>16.0</u>	<u>14.3</u>
	<u>100.0</u>	<u>100.0</u>
<u>Expenses</u>		
Interest on deposits	32.2	17.3
Remuneration to employees	27.3	25.8
Depreciation of bank premises	1.6	2.0
Other operating expenses	<u>15.7</u>	<u>18.9</u>
	<u>76.8</u>	<u>64.0</u>
Net operating earnings	<u>23.2</u>	<u>36.0</u>
<u>Distribution of net operating earnings</u>		
Provision for losses and additions to inner reserves	11.0	13.2
Provision for income taxes	46.2	35.5
Dividends to shareholders	27.4	21.3
Addition to shareholders' equity	<u>15.4</u>	<u>30.0</u>
	<u>100.0</u>	<u>100.0</u>

1 Source: Annual report of the Federal Deposit Insurance Corporation. Figures adjusted in some cases to fit Canadian titles.







BANK INSPECTION

22. One of the provisions of the first bank charter granted in 1822 authorized the bank to maintain branches and agencies, and this feature has been a part of every subsequent bank charter. At December 31, 1961, the eight banks had almost 5,400 branches, of which 157 were outside Canada. On the books of the branches and head offices, the banks now record over \$19 billion of assets consisting mostly of cash, securities and loans. For the purpose of examining and auditing these records, a system of inspection has been developed which we believe to be as comprehensive as any other in the world for similar institutions and more so than most. It is carried out by three agencies: bank officials, shareholders' auditors, and government officials.

Internal Supervision

23. A most important part in the inspection system of Canadian banks is the internal supervision and audit. A study of the bank failures of years ago indicates that many of them probably would have been avoided, or at least the losses greatly reduced, if efficient supervision of this type had been in effect. This internal control has been developed to a very high degree in the Canadian banking system of today.

24. Almost without exception, active loans are carried on the books of the branch through which the loan was made and at which any collateral security is held. With relatively minor exceptions, investment



1 securities are carried on the books of head office  
2 and in the physical custody of its officers. For  
3 convenience, or in special circumstances, (particularly  
4 in the case of foreign issues) some may be held at  
5 the branches. From the viewpoint of supervision and  
6 inspection, the investment security department at  
7 head office is treated in much the same manner as a  
8 branch office.

9 By a system of branch reports, the  
10 head office of a bank is kept informed of the  
11 situation in respect of all loans in excess of small  
12 individual limits. Strict rules are in effect  
13 regarding the type of security for loans which the  
14 branch manager may accept and the form in which it  
15 is to be hypothecated to the bank. All loans which  
16 become impaired are given special attention by  
17 branch managers and district supervisors and become  
18 the subject of special reports to, and attention by,  
19 head office officials.

20 26. The bank inspection staffs usually  
21 conduct examinations of all branches at least once  
22 annually and, if considered necessary, at more  
23 frequent periods. The officials who do this work  
24 are chosen from those whose experience and ability  
25 in the field of lending fit them for these important  
26 duties. They are accompanied by assistants who  
27 usually concentrate chiefly on auditing and routine.  
28 The branch is never advised in advance when an  
29 inspection will take place and every effort is made  
30 to preserve the element of surprise. Loans are







1 carefully scrutinized; cash, securities, collateral  
2 are verified and test confirmations of accounts are  
3 despatched to borrowers and depositors. The scope of  
4 the examination is very broad and in cases where tests  
5 only are prescribed, the inspector will enlarge the  
6 test if, in his opinion, it is warranted. Reports are  
7 made on other matters, such as the conduct of business  
8 at the branch, service to the public, quality of  
9 personnel and conditions in the community. Inspection  
10 reports are sent to head office where they are  
11 carefully studied by officers of the credit department  
12 and other officials and made available to the directors.  
13 Poor loan risks, irregularities and other pertinent  
14 matters are reported to and reviewed by the management  
15 and situations which require remedy are followed up  
16 and rectified as quickly as possible.

17 Shareholders' Audit

18 27. Following the failure of a bank in  
19 which the assets had been seriously dissipated  
20 through speculation, legislation to make shareholders'  
21 audits compulsory was first enacted in the Bank Act  
22 of 1913. It provided that the general managers of  
23 the banks should select each year a panel of not less  
24 than forty persons deemed by them to be competent  
25 to act as auditors. The selected names were then  
26 submitted to the Minister of Finance and, to the  
27 extent that he did not express disapproval, the list  
28 was published in the Canada Gazette and the share-  
29 holders of each bank were required to appoint one  
30 or more auditors for this list. Except for the







1 approval of a bank's general manager, there were  
2 no stipulations regarding training, ability or  
3 professional standing.

4 28. In 1922, following the necessary  
5 absorption of one of the larger banks to prevent a  
6 failure, the Minister of Finance caused to be made  
7 a special enquiry into the circumstances surrounding  
8 the impairment of its position and after very care-  
9 less auditing had been revealed, he recommended  
10 several amendments for the purpose of improving and  
11 strengthening the reporting and auditing provisions  
12 of the Bank Act.

13 The amendments enacted in 1923 are, with minor changes,  
14 still in force and are contained in section 61 of the  
15 Act. Some of the more important provisions are as  
16 follows:

17 (1) Only experienced members of provincially  
18 incorporated accounting institutions may  
19 act as bank auditors. The present  
20 incumbents are all practising chartered  
21 accountants who each have had many years  
22 of auditing experience.

23 (2) The Minister of Finance has the right to  
24 declare any person ineligible for appointment  
25 or to cancel the appointment of a bank  
26 auditor without accounting for his action.

27 (3) Two eligible accountants, not members of  
28 the same firm, must be appointed by the  
29 shareholders to audit the affairs of a  
30 bank. No two persons or members





1           respectively of the same firm may act  
2           together as auditors for more than two  
3           years in succession.

4           (4) The Minister may enlarge or extend the  
5           scope of the audit or direct that another  
6           or particular procedure be established, and  
7           he may require the auditors to report to  
8           him on any matter in respect of which he  
9           desires information.

10          (5) The auditors are required to report in  
11          writing to the president and general  
12          manager on any matter affecting the bank  
13          that they consider unsatisfactory and,  
14          in particular, upon any loan exceeding  
15          one percent of the paid-up capital and  
16          rest account of the bank which, in their  
17          judgment, is liable to result in a loss  
18          to the bank. At the same time they must  
19          give notice in writing to each director  
20          that a report has been made to the  
21          management and must send a copy of the  
22          report to the Minister. The report must  
23          be presented to the next directors'  
24          meeting and incorporated in the minutes.

25          29.               The auditors make an examination of  
26          several of the larger and more important branches  
27          annually and, in some cases, twice a year. A very  
28          large proportion of the cash and securities owned  
29          by a bank is carried at these larger branches and  
30          at head office. In addition, it is customary for







1 the auditors to review a number of the internal  
2 inspection reports each year to satisfy themselves  
3 that the procedure is adequate and that they may  
4 reasonably rely upon the methods of branch inspection  
5 to ensure accurate returns. In the course of their  
6 examination, they have access to all books and records  
7 at the head office of a bank, including branch  
8 returns, supervisors' reports, inspection reports  
9 and correspondence, and are entitled to receive  
10 from the officers of the bank all information they  
11 may require for the purposes of their audit. All  
12 loans over a comparatively small individual amount  
13 are examined and, in assessing the value of these  
14 credits, they have the benefit of the reports  
15 previously referred to, as well as the opinions of  
16 the senior credit officials of the bank.

17 Government Inspection.

18 30. The improved reporting and auditing  
19 requirements of the 1923 Bank Act quickly brought  
20 to light the very serious conditions existing in two  
21 banks. One of these was taken over by another bank  
22 and thus saved from failure. The other, the Home  
23 Bank of Canada, failed in 1923 and caused the biggest  
24 loss to depositors in the history of Canadian  
25 banking. A subsequent enquiry revealed hopelessly  
26 incompetent auditing by the person who had been  
27 charged with that duty for several prior years.  
28 This failure and the maladministration and lack of  
29 control which was disclosed caused a renewal of the  
30 demand for government inspection of banks and in





1 1924 the Bank Act was amended to provide for the  
2 appointment of an Inspector General of Banks.

3 31. This officer is appointed by the  
4 Governor in Council under the provisions of section  
5 62 of the Bank Act and is required from time to  
6 time, but not less frequently than once in each  
7 calendar year, to make or cause to be made such  
8 examination and enquiry into the affairs of each  
9 bank as he may deem to be necessary or expedient  
10 for the purpose of satisfying himself that the  
11 provisions of the Act having reference to the safety  
12 of the creditors and shareholders are being duly  
13 observed and that the bank is in a sound financial  
14 position. At the conclusion of each such examination,  
15 he is required to report thereon to the Minister of  
16 Finance.

17 32. The banks submit returns to the  
18 Minister of Finance on many pertinent matters and  
19 all of these come before the Inspector General  
20 for review. Among the returns received are monthly  
21 statements of assets and liabilities, statements of  
22 cash reserves, valuations of security portfolios,  
23 statements of earnings and expenses and classifications  
24 of loans and deposits. Also, once a year each bank  
25 furnishes to the Inspector General individual reports  
26 as at a prescribed date on all loans over a specified  
27 amount. In 1961 more than 3,600 of these reports  
28 covering aggregate outstanding loans of over  
29 \$4,200 million were received from the banks.  
30



1 33. From the various reports and returns  
2 received from each bank a considerable amount of pre-  
3 examination data is compiled and the actual time  
4 which would otherwise be spent at the head office is  
5 reduced accordingly. In conducting the examinations,  
6 unnecessary duplication of work is avoided when that  
7 work has already been efficiently carried out by bank  
8 inspectors or shareholders' auditors. The examinations  
9 do not embrace a physical check of cash or collateral  
10 or securities on hand, as this verification is already  
11 adequately covered by the latter. Considerable use  
12 is made of the results of the inspectors' and  
13 auditors' work in the study of the more important  
14 features of the bank's operations.

15 34. Particular attention is given to the  
16 quality of the larger individual loans and invest-  
17 ments and to the inner reserve positions. In practice,  
18 examinations are confined almost entirely to head  
19 offices where all files are available, including  
20 statements, reports, credit and other information  
21 concerning borrowers and investments. Individual  
22 loan risks are discussed where necessary with credit  
23 officers and executive officers of the bank and,  
24 in some cases, with the shareholders' auditors as  
25 well. Audit procedure and more important matters  
26 relating to the financial condition of each bank  
27 are reviewed with the shareholders' auditors. While  
28 it is the usual practice to make an inspection only  
29 once in each year, supplementary information is  
30 furnished on request, discussions are held with







1 executive officers from time to time and developments  
2 which may be considered to be of particular importance  
3 are kept under periodic review.

4 35. The banks are permitted by the Income  
5 Tax Act to set aside out of taxable income inner  
6 reserves to meet losses on loans and other invest-  
7 ments to the extent that the Minister of Finance  
8 may consider reasonable, having regard to all the  
9 circumstances. Rules for the determination of the  
10 maximum permitted reserves in each fiscal year are  
11 issued by the Minister and, following the annual  
12 examination of a bank, the Inspector General reports  
13 to the Minister whether its reserves are within the  
14 prescribed limits in order that the Minister may so  
15 inform the Minister of National Revenue as required  
16 by the Bank Act.

17 36. Every chartered bank is required to  
18 maintain a monthly average cash reserve of not less  
19 than 8 percent of its Canadian dollar deposit  
20 liabilities in the form of notes of and deposits  
21 with Bank of Canada, and to make monthly returns  
22 to the Minister and to Bank of Canada showing the  
23 status of these cash reserves for the month.

24 The Bank Act requires the Inspector General to  
25 make or cause to be made an examination of the  
26 books and records of each bank to satisfy himself  
27 that the returns are correct. As a large amount  
28 of detail work is involved, the shareholders'  
29 auditors of each bank are engaged to make this  
30 examination in accordance with an audit programme





1 prescribed by the Inspector General to whom they  
2 report and who in turn reports to the Minister and  
3 to the Governor of Bank of Canada.

4 37. The bank inspection situation in  
5 the United States is rather complex as there are  
6 several authorities involved. The Comptroller of  
7 the Currency is required to examine every national  
8 bank twice a year. One such examination may be  
9 waived but not for more than one year at a time.  
10 State banks are subject to inspection requirements  
11 in accordance with the laws of the individual states.  
12 In addition the Federal Reserve system may examine  
13 all its national and state member banks and the  
14 Federal Deposit Insurance Corporation may examine  
15 all its national and state insured banks. In  
16 many cases duplication of examination is avoided  
17 by arrangement between the authorities. At  
18 December 31, 1960 there were 4,537 national banks,  
19 8,919 state commercial banks and 515 mutual savings  
20 banks, a total of 13,971 with 10,801 branches,  
21 and the examining staff of the Comptroller of the  
22 Currency alone numbered 877.

23 In Great Britain there is no  
24 government bank inspection similar to that in  
25 Canada. Information is furnished to the Bank of  
26 England from time to time on request, but the  
27 final audit responsibility rests with the share-  
28 holders' auditors who report under the terms of  
29 the Companies Act. The Board of Trade has authority  
30 to examine the affairs of a bank if its financial





1 condition is considered to be unsound.

2 39. In some other European countries  
3 there is no bank inspection by government or central  
4 bank authorities, while in others one or the other  
5 of these authorities is responsible but the degree  
6 of supervision varies greatly.

7 40. In Australia a fairly detailed annual  
8 inspection of national banks is carried out by the  
9 Auditor General who reports to the Minister of  
10 Finance.





INNER RESERVES

41. The banks maintain three types of inner reserves, namely,

(1) Specific reserves, which are required by the Bank Act to provide for estimated losses on loans and for market depreciation of securities other than those of Canada and the provinces and on long foreign exchange positions,

(2) Contingency reserves, which are for the purpose of meeting losses in excess of those covered by specific reserves which may occur but which are not apparent at the time, and

(3) Tax paid reserves, on which no further income taxes are exigible and the amount of which is in effect undisclosed rest or surplus.

42. Section 68 of the Bank Act reads as follows:

"68. (1) Where in the opinion of the Minister an amount set aside or reserved by any bank out of income, either by way of write-down of the value of assets or appropriation to any contingency reserve or contingent account for the purpose of meeting losses on loans, bad or doubtful debts, depreciation in the value of assets other than bank premises or other contingencies, is in excess of the reasonable requirements of the bank having





1 regard to all the circumstances, the Minister  
2 shall notify the Minister of National Revenue  
3 of the amount so set aside and of the amount  
4 of such excess.

5 (2) Nothing in subsection (1) shall be  
6 construed to give the Minister any jurisdiction  
7 over the discretion of the directors of the  
8 bank with regard to amounts set aside, reserved  
9 or transferred to any reserve or other account  
10 from income upon which taxes have been  
11 assessed under any Act of the Parliament of  
12 Canada imposing a tax upon or in respect of  
13 income."

14 43. By definition subsection (1) refers  
15 to specific and contingency reserves and subsection  
16 (2) refers to the tax paid reserves. Rules of the  
17 Minister of Finance for the determination of the  
18 maximum permitted reserves of a bank under sub-  
19 section (1) are issued annually. A copy of the  
20 Rules for the fiscal years ended in 1961 appears  
21 on pages A.29 to A.32 following. A formula based  
22 on the average loss experience of the entire banking  
23 system for the past twenty-five years is used to  
24 establish a reserve percentage. This when applied  
25 to the related asset values establishes the maximum  
26 amount of non-taxed specific and contingency  
27 reserves that a bank is permitted to have. For the  
28 banks as a whole the permitted contingency reserves  
29 at the 1961 fiscal year ends amounted in the  
30 aggregate to \$320 million or 3.287 percent of related







1 assets after deduction of specific reserves from the  
2 maximum reserves allowed.

3 44. In respect of the undernoted assets  
4 eligible for non-taxed specific and contingency  
5 reserves under the Canadian formula, the tax laws  
6 of other countries we have studied are in many  
7 respects different from ours. With the exception  
8 of the United States no general (contingency)  
9 reserves may be created from taxable income. Specific  
10 reserves for bad debts are permitted but none for  
11 valuation of securities other than those partially  
12 or wholly worthless.

13 45. The United States allows a general  
14 reserve as well as specific reserves on loans if  
15 a bank elects to adopt this accounting method rather  
16 than make a direct charge of annual losses against  
17 operating profits. At December 31, 1960 approximately  
18 65 percent of the national banks in the United States  
19 holding over 94 percent of the aggregate loans of the  
20 system were using the reserve method of accounting  
21 and the total of their bad debt reserves equalled  
22 approximately 2 percent of these loans. The  
23 calculation of the maximum reserve for each bank is  
24 three times its ratio of loss experience on related  
25 loans for any twenty consecutive years after 1927  
26 applied to loans at the end of its fiscal year.

27 46. From time to time suggestions have  
28 been made that the amount of the inner reserves of  
29 banks should be published or alternatively that the  
30 amount for the system as a whole should be made





1 public annually. To date it has been the policy  
2 of each Canadian government that these amounts should  
3 not be disclosed. The disclosure of the total reserves  
4 for the system would provide a method of calculating  
5 its annual loss experience which fluctuates consider-  
6 ably at times.

7 47. In European countries no figures of  
8 inner reserves of a bank or of the entire system are  
9 published, and in Great Britain the Cohen Commission  
10 on Company Law in 1945 recommended that a bank should  
11 not be required to disclose the amount of its inner  
12 reserves. In the United States the Comptroller of  
13 the Currency publishes the aggregate of the bad debt  
14 reserves of almost 3,000 national banks that use the  
15 reserve method of accounting. These figures appear  
16 about seven months after the close of the year.

17 48. The maximum reserve that may be  
18 created by a bank out of taxable profits is, as noted  
19 above, prescribed by the Minister of Finance. As  
20 subsection (2) of section 68 of the Act specifically  
21 excludes the tax paid reserves from his jurisdiction,  
22 the publication of individual or collective figures  
23 in respect of the latter would require further  
24 consideration.

25  
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27  
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1 RULES FOR THE DETERMINATION OF THE INNER RESERVES  
2 OF A BANK FOR THE FISCAL YEAR ENDING  
3 IN 1961

4 Issued by the Minister of Finance  
5 pursuant to sections 9 and 11(4) of the Income  
6 Tax Act

7 September 27, 1961

8 1. THE INNER RESERVES of a bank, for the purposes  
9 of these Rules, include all of its unpublished  
10 reserves other than the Bank Premises Depreciation  
11 Reserves.

12 2. THE TAX PAID RESERVES of a bank include all its  
13 inner reserves upon which the taxes exigible by the  
14 Government of Canada have been assessed.

15 3. THE SPECIFIC RESERVES of a bank include all its  
16 inner reserves in respect of particular securities,  
17 loans, letters of credit and net long foreign exchange  
18 positions, that are required to reduce the book  
19 values of the relative assets to estimated realizable  
20 values.

21 4. THE LOSS EXPERIENCE of a bank includes

22 (a) in respect of securities, all provisions  
23 for specific reserves and reversals of these  
24 provisions;

25 (b) in respect of loans and letters of credit,  
26 all losses and recoveries of losses, provisions  
27 for specific reserves and reversals of these  
28 provisions; and

29 (c) in respect of long foreign exchange positions,  
30 all realized profits and losses, provisions for  
specific reserves and reversals of these provisions.







1 The net amount of the annual loss experience is to  
2 be transferred to the Contingency Reserves at the  
3 end of the fiscal year and added thereto or deducted  
4 therefrom as the case may be.

5 5. THE CONTINGENCY RESERVES of a bank include all  
6 its remaining inner reserves, and the prescribed  
7 aggregate of these reserves, hereinafter referred to  
8 as PAR, is an amount equal to 4.008% of the aggregate  
9 book value of the assets described in Rule 6, less  
10 an amount equal to the total of all specific reserves  
11 in respect of these assets up to a maximum deduction  
12 of 4.008% of their aggregate book value.

13 6. THE ASSETS referred to in Rule 5 for the  
14 calculation of PAR are

15 (a) Securities other than 1) those of or  
16 guaranteed by the Government of Canada or a  
17 Canadian province, 2) those of or guaranteed  
18 by the Government of the United States or the  
19 United Kingdom issued for a term of less than  
20 one year, 3) shares of capital stock of  
21 corporations held for Investment account and  
22 4) securities and shares of a corporation  
23 controlled by the bank.

24  
25 (b) Loans and Letters of Credit other than  
26 1) day-to-day loans in Canada, 2) those to  
27 or guaranteed by the Government of Canada, the  
28 United States, the United Kingdom or a Canadian  
29 province, 3) those on the security of Canada  
30 Savings Bonds at the agreed rate for the issue,



1 including those to employers under a payroll  
2 savings plan, 4) those to or guaranteed by other  
3 banks, 5) those which are not bearing interest  
4 because of a contra deposit, 6) those to  
5 municipalities or charitable organizations which  
6 are offset by a contra deposit bearing the same  
7 rate of interest, 7) those to a corporation  
8 controlled by the bank, and 8) mortgages and  
9 hypothecs insured under the National Housing  
10 Act, 1954.

11 7. If the total of the Contingency Reserves, after  
12 making the transfer pursuant to Rule 4, is greater  
13 than PAR at the end of a fiscal year, the surplus is  
14 to be deducted from the Reserves and added to the  
15 taxable income of the fiscal year.

16 8. If the total of the Contingency Reserves, after  
17 making the transfer pursuant to Rule 4, is less than  
18 PAR at the end of a fiscal year, any part of the  
19 deficiency may be extinguished by a transfer from  
20 the taxable income of the fiscal year.

21  
22 Note 1 - The Contingency Reserve percentage in  
23 Rule 5 is determined by multiplying the  
24 Contingency Reserve percentage for the  
25 immediately preceding year by the ratio  
26 of average annual loss experience to  
27 related assets for the 25 financial years  
28 ended in that year, and dividing the  
29 result by the ratio of average annual  
30 loss experience to related assets for the







Nethercut & Young

Toronto, Ontario

A. 32

1 25 years ended in the year immediately  
2 preceding that year.  
3

4 Note 2 - Rules for 1962 have not yet been issued  
5 but the formula in use produces a maximum  
6 reserve percentage of 3.624 for the fiscal  
7 year..  
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CASH RESERVES

1  
2 49. Section 71 of the Act deals with  
3 cash reserves, the basis of which has been altered  
4 several times in the past. After the advent of the  
5 Bank of Canada in 1934, a bank was required to  
6 maintain at all times a reserve of not less than  
7 5 percent of its deposit liabilities within Canada  
8 in the form of notes of and deposits with the central  
9 bank. The 1944 Act altered the base to deposit  
10 liabilities payable in Canadian currency and the  
11 1954 Act changed to the present formula which requires  
12 a bank to maintain a cash reserve of not less on  
13 the average during any month than 8 percent of its  
14 Canadian dollar deposits. Bank of Canada has the  
15 authority to raise this percentage to a maximum of  
16 12 percent over a period of time but this has never  
17 been exercised to date.

18 50. Almost 90 percent of interest bearing  
19 deposits payable in Canadian currency are in the  
20 form of personal savings deposits of which the  
21 greater number are subject to chequing and in effect  
22 are on a demand basis. No attempt has been made in  
23 Canada to set different reserve percentage rates on  
24 interest bearing and non-interest bearing deposits.  
25  
26

NOTE ISSUE

27  
28 51. Banks are now prohibited by section  
29 72 of the Act from issuing or reissuing their notes  
30 for circulation within Canada or elsewhere. When they





1 had this power an additional liability attached to  
2 the shares of capital stock if the bank became in-  
3 solvent, but this expired at January 1, 1950 when  
4 each bank paid to the Bank of Canada an amount equal  
5 to its respective outstanding Canadian note issue and  
6 the central bank assumed liability for the redemption  
7 of all chartered bank notes payable in Canadian dollars.  
8 The amount of this liability outstanding at December  
9 31, 1961 was approximately \$8.5 million. The  
10 liability of all banks for foreign notes outstanding  
11 is less than \$100,000.

#### 12 13 BRANCHES

14 52. The power given to the banks in  
15 section 75 (1) of the Act to open and operate  
16 branches both in Canada and abroad has been a feature  
17 of our banking legislation since before Confederation.  
18 At December 31, 1961 the banks had 5,225 branches  
19 in Canada and 157 elsewhere. The opening and closing  
20 of branches is entirely within the discretion of bank  
21 management and no approval is required from any  
22 government authority.

23 53. This freedom with respect to branch  
24 operations was a part of the charter of the first  
25 bank of the United States. Now, however, branch  
26 openings in that country are subject to the laws  
27 of the respective states, in many of which none is  
28 allowed while in others only the approval of the  
29 state banking authority is required.

30 54. In Great Britain and other western







1 European countries there are no restrictions in  
2 respect of branch openings, although in some of the  
3 latter a permit is required but apparently is not  
4 difficult to obtain.

5  
6 BUSINESS OF BANKING

7 55. Section 75(1)(e) of the Act authorizes  
8 the banks to "engage in and carry on such business  
9 generally as appertains to the business of banking".  
10 It is under this provision that many of the  
11 operations, not specifically authorized but not  
12 prohibited are carried on. Some definitions of the  
13 "business of banking" are submitted as an Appendix,  
14 pages A.46 to A.52.

15  
16 LENDING POWERS

17 56. The prohibition in section 75(2)(d)  
18 of the Act against lending on the security of real  
19 or immovable property or of ships and vessels except  
20 as authorized by this and certain other Acts is  
21 largely inoperative. Banks may make mortgage loans  
22 under the National Housing Act, the Farm Improvement  
23 Loans Act, the Fisheries Improvement Loans Act, the  
24 Veterans Business and Professional Loans Act and  
25 the Small Businesses Loans Act, and may purchase or  
26 loan on the security of mortgage bonds or debentures  
27 of a corporation. The only ineligible borrower on  
28 mortgage security appears to be the non-corporate  
29 person who cannot borrow under the terms of one of  
30 the above Acts.





1 57. Subject to limitations with respect  
2 to terms of the loan and the valuation of the  
3 property, national banks in the United States may  
4 make first mortgage loans on real estate, but the  
5 value of all such loans outstanding must not exceed  
6 the amount of the capital and surplus of the bank,  
7 or 60 percent of its time and savings deposits,  
8 whichever is greater. Powers under the state laws  
9 vary considerably but mortgage lending is permitted  
10 by most of them.

11 58. Banks in Great Britain are not  
12 restricted in the security that may be taken for  
13 loans. Those in other western European countries  
14 are not prohibited from lending on the security of  
15 mortgages although some find it unprofitable to do  
16 so because of relative laws. National banks in  
17 Australia may lend on the security of mortgages.

18 59. The power in section 75(6) of the Act  
19 to make loans upon the security of household property  
20 including motor vehicles to other than a manufacturer  
21 thereof or a dealer therein was first enacted in  
22 1954 and there has been a substantial increase in  
23 personal loans by the banks since that time.

24 60. Sections 86 to 90 of the Act are  
25 unique and permit the banks to take and register  
26 with Bank of Canada security that would otherwise  
27 be subject to the laws of the province in which it  
28 is located. These sections have a long and interesting  
29 background in Canadian banking and there have been  
30 numerous amendments as the list of eligible security







1 has been broadened from time to time. A brief  
2 history of these is submitted as an Appendix, pages  
3 A.53 to A.56. There is no doubt that these powers have  
4 enabled the banks to be of assistance in the past to  
5 many borrowers who would not be eligible for loans  
6 otherwise.

7 61. A classification of loans of the  
8 chartered banks in Canadian currency as at March 31,  
9 1962 appears on the following pages A. 38 and A. 39.



## CLASSIFICATION OF LOANS IN CANADIAN CURRENCY

OF

## THE CHARTERED BANKS OF CANADA

	March 31, 1962		March 31, 1961	
	Number of Accounts	Millions of Dollars	Number of Accounts	Millions of Dollars
1. GOVERNMENT AND OTHER PUBLIC SERVICES				
(1) Provincial governments.....	48	14.3	57	55.7
(2) Municipalities and school corporations.....	4,493	343.9	4,370	309.0
(3) Religious, educational, health and welfare institutions.....	6,672	206.2	5,967	182.0
Total Government and Other Public Services.....	11,213	564.4	10,394	546.7
2. INVESTMENT DEALERS AND BROKERS				
(1) Investment dealers, day-to-day, secured.....	68	153.2	59	138.3
(2) Investment dealers, call and short, secured.....	219	37.4	335	53.5
(3) Stockbrokers, call and short, secured.....	463	53.9	462	49.6
Total Investment Dealers and Brokers	750	244.5	856	241.4
3. PERSONAL				
(1) Individuals, for other than business purposes				
(a) On the security of Canada Savings Bonds at the agreed rate for the issue.....	137,506	126.1	128,927	126.5
(b) On the security of marketable stocks and bonds.....	129,885	351.7	115,371	283.4
	267,391	477.8	244,298	409.9
(2) Individuals, for other than business purposes				
(a) For Home Improvement, under the National Housing Act.....	62,995	65.0	65,995	56.1
(b) On the security of motor vehicles.....	161,491	198.3	121,357	155.3
(c) On the security of other household property.....	49,218	38.8	34,828	29.3
(d) Repayable by instalments, not elsewhere classified.....	448,188	300.9	421,557	282.5
(e) Repayable otherwise, not elsewhere classified.....	501,540	528.6	423,015	405.9
Total Personal.....	1,490,823	1,609.4	1,311,050	1,339.0



	March 31, 1962		March 31, 1961	
	Number of Accounts	Millions of Dollars	Number of Accounts	Millions of Dollars
4. AGRICULTURAL, INDUSTRIAL AND COMMERCIAL				
(1) Agriculture				
(a) Farmers, under Farm Improvement Loans Act.....	140,807	186.2	140,691	174.5
(b) Farmers, not elsewhere classified.....	148,379	257.1	145,605	217.1
	289,186	443.3	286,296	391.6
(2) Industry				
(a) Chemical and rubber products..	778	58.9	721	56.1
(b) Electrical apparatus and supplies.....	1,551	72.4	1,665	65.0
(c) Food, beverages and tobacco...	7,067	218.9	6,662	183.6
(d) Forest products.....	8,366	216.1	8,406	198.7
(e) Furniture.....	1,436	30.0	1,356	26.1
(f) Iron and steel products.....	3,285	226.5	3,263	209.9
(g) Mining and mine products.....	1,527	105.5	1,368	86.4
(h) Petroleum and products.....	994	92.4	1,004	104.7
(i) Textiles, leather and clothing	4,413	208.9	4,202	182.3
(j) Transportation equipment.....	3,254	128.8	5,551	75.9
(k) Other products.....	4,305	106.0	3,702	83.1
	36,976	1,464.4	37,900	1,271.8
(3) Public utilities, transportation and communication companies				
(a) Guaranteed by a province.....	141	4.1	189	6.4
(b) Other.....	8,578	159.8	8,238	177.2
	8,719	163.9	8,427	183.6
(4) Construction contractors.....	25,013	323.2	23,862	303.3
(5) Grain dealers and exporters.....	859	286.6	873	418.9
(6) Instalment and other finance companies.....	1,107	257.0	1,059	295.6
(7) Merchandisers.....	92,643	968.9	86,117	869.5
(8) Other business.....	96,305	848.3	83,073	638.5
Total Agricultural, Industrial and Commercial.....	550,808	4,755.6	527,607	4,372.8
TOTAL LOANS IN CANADIAN CURRENCY (Other than mortgages and hypothecs insured under the National Housing Act, 1954).....	2,053,594	7,173.9	1,849,907	6,499.9

## SUPPLEMENTARY INFORMATION

5. Par value of Government of Canada securities held as security for loans in classification 3(1).....	-	232.9	-	213.1
6. Loans to finance companies controlled by industrial corporations included in classification 4(6).....	64	49.5	87	77.7
7. Loans under the Small Businesses Loans Act, gross.....	3,411	27.2	306	1.8







LOAN INTEREST AND CHARGES

62. Provisions limiting the maximum rate of interest or discount that a bank may charge on a loan or advance have appeared in all Bank Acts since 1867. The stipulated rate was 7 percent per annum until 1944 when it was reduced to the present rate of 6 percent per annum as specified in section 91 of the Act. Prior to 1934 the Acts provided that no higher rate was recoverable by the bank, but there was no penalty if a higher rate was received. Since that time the bank has been liable to a fine of \$500 and the officer making the charge to a fine of \$100 for any violation.

63. Subsection (2) of section 93 of the Act provides that the bank may make a charge for the keeping of an account if express agreement is obtained from the customer. This provision, first enacted in 1923, has enabled some of the banks to obtain further gross revenue on certain types of loans in addition to the interest or discount charged.

64. In Great Britain and other western European countries there are no limits on the rate of interest that a bank may charge on a loan or overdraft other than the normal laws of usury. Australia has a maximum rate of 7 percent per annum.

65. The National Banking Law of the United States provides that a national bank may charge interest at the rate allowed to a state bank in the state in which the bank is situated or at a rate of 1 percent in excess of the discount rate on 90 day





1 commercial paper in effect at a Federal Reserve bank  
2 in the district, whichever is the greater, and where  
3 there is no relative state law the bank may charge  
4 7 percent or 1 percent over the Federal Reserve  
5 discount rate, whichever is the greater.

6 66. The Banking Law of New York State  
7 (as an example) provides for a maximum interest or  
8 discount rate of 6 percent per annum except as  
9 follows:

10 (1) Upon demand loans of \$5,000 or more secured

11 by warehouse receipts, bills of lading,  
12 certificates of stock, certificates of  
13 deposit, bills of exchange, bonds or other  
14 negotiable instruments, the bank may contract  
15 for or receive any sum agreed upon with the  
16 customer.

17 (2) When authorized by the Superintendent of  
18 Banking to operate a personal loan department,  
19 the bank may charge interest at a rate not to  
20 exceed 1 percent per month on the outstanding  
21 balance or 6 percent discount on the total  
22 amount of the loan which must not exceed  
23 \$5,000. The charge includes all expenses  
24 such as interest, fees and commissions but  
25 not the cost of life insurance and no offsetting  
26 or compensating deposit balances may be required.

27 67. Compensating balances in respect of  
28 other than personal loans are permitted in most if  
29 not all of the United States and the practice of  
30 requiring these deposit balances as a condition of





1 extending loans or lines of credit has become  
2 increasingly widespread during the past ten years.  
3 It would appear that a majority of the large banks  
4 may require from 10 percent to 20 percent of the  
5 amount of the loan to be carried on deposit. In  
6 almost all cases the required volume of deposits  
7 is defined in terms of average balances held over  
8 the period.

9 68. When compensating balance requirements  
10 exceed the borrower's normal working balance needs,  
11 the requirements force him to pay interest on  
12 balances he is not using and in effect pay a higher  
13 than contract rate on his loan. On the other hand,  
14 the bank does not realize full earnings on the  
15 entire amount of the compensating balance as a  
16 portion must be set aside for required cash reserves.

#### 18 DEPOSIT INTEREST

19 69. As noted in the portion of this  
20 submission dealing with cash reserves almost 90  
21 percent of interest bearing deposits payable in  
22 Canadian currency are in the form of personal  
23 savings accounts on which the banks permit chequing.  
24 Changes in the rates paid on these deposits since  
25 the turn of the century are shown in the following  
26 table:

27 (1) On minimum monthly balance

28	3%	-	1900
29	2½%	-	May 1, 1933
30	2%	-	November, 1, 1934
	1½%	-	June 1, 1936







## (2) On minimum quarterly balance

 $1\frac{1}{2}\%$  - March 31, 1939 $2\%$  - December 1, 1953 $2\frac{1}{4}\%$  - August 1, 1956 $2\frac{1}{2}\%$  - September 15, 1956 $2\frac{3}{4}\%$  - February 1, 1957

70. Interest bearing deposits in the national banks of the United States are not subject to withdrawal by cheque. In western European countries no chequing is allowed on time and savings deposits, but in some cases a low rate of interest is paid on sight deposits.

UNCLAIMED BALANCES

71. Banks are required by section 94 of the Act to pay to Bank of Canada in trust for the rightful owner an amount equal to all deposits, bills of exchange and other like instruments payable in Canadian currency and unclaimed for a period of ten years. If an amount is for less than \$10 and remains unclaimed after thirty years, it is prescribed and paid to the Receiver General of Canada for the Consolidated Revenue Fund. At December 31, 1961 Bank of Canada held approximately \$5,345,000 of unclaimed accounts after payments to the Receiver General of prescribed balances amounting to approximately \$271,000.

AMALGAMATIONS

72. Sections 100 to 102 of the Act first





1 enacted in 1954 prescribe the conditions under which  
2 any two or more banks may amalgamate for the purpose  
3 of continuing as one bank. The relative agreement  
4 must be submitted to the shareholders only after  
5 approval to do so is obtained from the Minister and,  
6 if approved by shareholders holding not less than  
7 two-thirds of the capital stock of each bank, the  
8 agreement may be executed on behalf of each bank,  
9 but has force and effect only after it is further  
10 approved by the Governor in Council.

11 73. Since these amendments were enacted  
12 there have been three amalgamations:

13 (1) The Bank of Toronto and The Dominion Bank

14 became The Toronto-Dominion Bank;

15 (2) Imperial Bank of Canada and Barclays Bank

16 (Canada) became Imperial Bank of Canada;

17 (3) The Canadian Bank of Commerce and Imperial

18 Bank of Canada became Canadian Imperial

19 Bank of Commerce.

20  
21 RETURNS

22 74. Sections 103 to 119 of the Act  
23 enumerate the returns that the banks are required  
24 to make to the Minister, namely,

25 (1) A monthly return of assets and liabilities

26 (2) A monthly return of cash reserves in Canada

27 (3) An annual return of foreign currency assets  
28 and liabilities

29 (4) An annual return of earnings and expenses

30 (5) An annual return of loans in Canadian currency





1 (6) An annual return of deposit liabilities in  
2 Canadian currency in Canada

3 (7) An annual return of unclaimed balances in  
4 Canadian currency

5 (8) An annual return of interest charges

6 (9) An annual return of unused real estate

7 (10) An annual return of directors with the  
8 companies of which they are directors or  
9 members

10 (11) An annual return of shareholders.

11 75. Section 117 of the Act authorizes the  
12 Minister to obtain such other information in such  
13 form as he may require and there are several supple-  
14 mentary returns, such as

15 (1) A quarterly classification of loans and

16 (2) A semi-annual statement of securities

17 as well as explanatory information submitted on request  
18 from time to time.  
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APPENDIX

BANKS AND BANKING

DEFINITIONS AND LEGAL OPINIONS

A1. While there have been several legal decisions which held that certain operations were within the legitimate business of banking, none appears to state that any of these are exclusively so. One of the difficulties that would arise in writing a statutory definition is that the two primary functions of banking are very similar to other common commercial transactions since

(1) the receipt of a customer's deposit is a form of borrowing money from the public, and

(2) the payment of a customer's cheque can be compared to the acceptance of a draft by a debtor.

It is the combination of these two functions, particularly in regard to deposits payable on demand or to order, that appears to be the principal business of banking.

A2. Falconbridge in his Sixth Edition on Banking and Bills of Exchange states that primarily the business of a bank consists in the receipt of deposits from customers and the payment of its customers' cheques and this appears to be the consensus of legal opinion. There are of course further functions such as 1) lending of money, 2) investment in securities, 3) collection for customers of cheques and other instruments, 4) issue of letters of credit and like instruments and 5)





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acceptance for safe custody of property such as bonds, documents or other valuable articles.

A3. Bouvier's Law Dictionary defines "bank" as an institution authorized to receive deposits of money, to lend money, to issue promissory notes, usually known by the name of bank notes or to perform one or more of these functions.

A4. Halsbury Laws of England, Third Edition, defines the business of banking at page 151 as the receipt of money on current or deposit account and the payment of cheques drawn by and the collection of cheques paid in by a customer.

A5. Hart's The Law of Banking defines a banker as one who in the ordinary course of his business receives money which he repays by honouring the cheques of the person from or on whose account he receives it.

A6. Hart also describes the functions of a banker as follows:

(1) He is debtor of his customer and must discharge his indebtedness by honouring his customer's cheques.

(2) He usually undertakes expressly or by implication to honour bills of exchange accepted by his customers and made payable at his bank to the extent of his customer's balance or to an agreed amount. He sometimes accepts bills drawn on him by his customer.

(3) He acts as agent of his customer in such





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things as collections, procuring of securities, etc.

(4) He is often bailee of deeds and other valuable articles entrusted to him by his customer for safekeeping.

(5) He issues letters of credit and like instruments.

A7. In Attorney General of Alberta v. Attorney General of Canada (reference Alberta bills) (1938) S.C.R. 100, Duff, C.J., at page 116, defined a banker as "a dealer in credit".

A8. Banking has been held to comprehend every kind of transaction coming within the legitimate business of a banker. Tennant v. Union Bank of Canada (1894) A.C. 31 at page 46; including the lending of money on the security of goods or documents representing the property of goods. Currie v. Harris Lithographing Co. of Canada (1917) 41 O.L.R. 475.

A9. "The receiving of money on deposit, allowing the same to be drawn against as and when the depositor desires and paying interest on the amounts standing on deposit" has been held to constitute the business of banking in England: Re Bottomgate Industrial Co-operative Society (1891) 65 L.T. 712 at 714.

A10. In Attorney General of Alberta v. Attorney General of Canada (1947) A.C. 503, it was held that "banking" includes the making of loans for the purpose of expanding credit. The transaction of







## APPENDIX

1 receiving from depositors bank deposits and repaying  
2 those deposits comes within the legitimate business  
3 of a banker and is, therefore, the proper subject  
4 of legislation for the Parliament of Canada.

5 Attorney General of Canada v. Attorney General of  
6 Quebec (1947) A.C. 33.

7 All. Some of the business legitimately carried  
8 on by a banker was described in Re Bergethaler  
9 Waisenamt, (1949) 1 D.L.R. 769, as follows:

10 "Expert opinion was not given in  
11 evidence in this case as to what is banking  
12 business, but it is common knowledge that during  
13 the period of the corporation's operations  
14 banking did include the following: (1) Receiving  
15 money on deposit from its customers. (2) Paying  
16 a customer's cheques or drafts on it to the  
17 amount on deposit by such customers, and holding  
18 Dominion Government and Bank notes and coin for  
19 such purpose. (3) Paying interest by agreement  
20 on deposits. (4) Discounting commercial paper  
21 for its customers. (5) Dealing in exchange and  
22 in gold and silver coin and bullion. (6) Collect-  
23 ing notes and drafts deposited. (7) Arranging  
24 credits for itself with banks in other towns,  
25 cities and countries. (8) Selling its drafts  
26 or cheques on other banks and banking  
27 correspondents. (9) Issuing letters of credit.  
28 (10) Lending money to its customers: (a) on the  
29 customers' notes; (b) by way of overdraft;  
30 (c) on bonds, shares and other securities.





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The business of a Canadian chartered bank is wider still because of the statutory rights and powers given to a bank under the provisions of the Bank Act."

".....The business carried on by most banks includes the totality of the functions I have enumerated, but, of course, a banking business can be carried on without performing all of them and most corporations and individuals engaged in a financial business of any kind are required to carry on or perform some of them and it does not follow from the fact that banks perform them that every exercise of one or more of the functions is a form of banking."

Al2. As to what extent a province can establish a banking system, the case of *In re Dominion Trust Co.* (1918) 3 W.W.R. 1023, is worthwhile considering. In that case it was held (which was the judgment of a single judge) that a provincial legislature has power to incorporate a company with the object of carrying on that branch of banking which consists of accepting money on deposit, paying interest thereon and allowing the customer to withdraw his money by a bill of exchange. It was argued in this case that the province could not so legislate and Murphy, J., said at page 1025: "If such a construction of the British North America Act is correct, it seems to follow that a province cannot authorize a provincial company to discount a





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1 bill of exchange since that is in one phase a  
2 banking operation. Since shipping is likewise  
3 exclusively within the legislative ambit of the  
4 Dominion, it would likewise follow that no province  
5 could authorize a provincial company to engage in the  
6 operation of steamboats or other craft within the  
7 province and so on with regard to all subjects under  
8 .....section 91 of the B.N.A. Act.....I  
9 decline to place a construction on that statute  
10 which would have disastrous results on the business  
11 of numerous provincial companies."

12 A13. In Corpus Juris Secundum, Volume 9,  
13 at page 28, a bank is defined as an association or  
14 corporation whose business it is to receive money on  
15 deposit, cash cheques or drafts, discount commercial  
16 paper and make loans. The business of banking has  
17 a corresponding meaning.

18 A14. In Anten v. U.S. National Bank of New  
19 York 174 U.S. 125, it was stated that banking is the  
20 receiving of money of others on general deposit to  
21 form a joint fund that can be used by the bank for  
22 its own benefit for one or more of the purposes of  
23 making loans and discounts. It also embraces the  
24 business of dealing in notes, foreign and domestic,  
25 bills of exchange, coin, bullion, credits and the  
26 remission of money and the privileges of receiving  
27 special deposits and of making collections for the  
28 holders of negotiable instruments.

29 A15. As a matter of interest (and of perhaps  
30 argument) the expression "banking institution" has









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1  
2 been held by at least one court to include a trust  
3 company within the meaning of a contract for the  
4 underwriting of shares of stock by any "banking  
5 institution". Montreal Trust Co. v. Richardson  
6 (1922) 1 W.W.R. 548.  
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HISTORY OF SECTIONS 86 - 90 OF THE BANK ACT

The first provisions towards the present section 88 of the Bank Act were enacted by the Province of Canada in 1859, "An Act Granting Additional Facilities in Commercial Transactions" and referred principally to bills of lading and similar documents. The provisions giving section 86 and 88 security preference over the claim of an unpaid vendor have their origin in this early legislation.

1871. The pre-Confederation legislation with respect to bills of lading, warehouse receipts and other receipts was repeated in the main, but with some important differences. Previously, the security might only be acquired at the time the debt to the bank was negotiated or contracted. It now became lawful to acquire it by virtue of an understanding entered into at the time. It was also provided that the debt might be renewed without affecting the security, and the list of persons from whom security could be taken and the list of goods which were available for such security were enlarged. References: S45 to S50.

1880. A broader definition was given to the phrase "goods, wares and merchandise", and the list of persons who might borrow was enlarged to include a saw-miller, manufacturer of timber, curer or packer of meat, tanner and purchasers of agricultural products. Provision was made whereby a bill of lading





1 could be exchanged for a warehouse receipt covering  
2 the same goods and vice versa. Reference: S7.

3 1888. The list of persons granting warehouse  
4 receipts and bills of lading was enlarged to include  
5 distillers and manufacturers of wool and cotton.

6 Reference: S1.

7 1890. The sections dealing with bills of  
8 lading and warehouse receipts were completely revised.  
9 Besides being able to make advances against such  
10 securities, the banks were authorized to lend money  
11 to a manufacturer upon the security of goods  
12 manufactured by him or procured for such manufacture  
13 and to a wholesale purchaser or shipper of or dealer  
14 in primary products upon the security of such products.  
15 The security was to be given in the form of an  
16 assignment in accordance with a form set forth in the  
17 Act, and the bank thereby acquired the same rights  
18 as under a warehouse receipt. Thereafter, only a  
19 person having goods actually in his possession as  
20 bailee and not as owner could issue a valid warehouse  
21 receipt. References: S2 and S73 to S78.

22 1900. Receipts for logs and timber in transit  
23 were included in "warehouse receipts" and definition  
24 of "manufacturer" broadened to include a manufacturer  
25 of logs, timber or lumber. The products of the quarry  
26 were added to those upon which a wholesale purchaser  
27 or shipper could borrow. References: S2 and S17.

28 1913. Provision was made to enable farmers  
29 to borrow on the security of threshed grain grown  
30 upon the farm. References: S2 and S86 to S90.







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1915. Provision was made for farmers to borrow for the purchase of seed grain on the security of the seed grain and the crop to be grown therefrom. Reference: S1.

1916. Provision was made for persons engaged in stock raising to borrow upon the security of the livestock. Reference: S2.

1923. Provision was made that any person intending to give a bank security under section 88 must give notice of such intention before any loan was made or the security taken and that such notice must be registered. References: S2 and S86 to S90.

1934. Several articles eligible as security were added under the definitions relating to primary products. Provision was made to enable a farmer to borrow for the purchase of binder twine on the security of the twine and the crop to be grown. Also provision was made to authorize the surrender of a bill of lading and to receive in exchange security on the goods covered by it. Also the Act was amended to bring the provisions into accord with the method of handling grain recognized by the Canada Grain Act in order that a continuous security upon the same or substituted grain could be maintained. References: S2 and S86 to S90.

1944. Definitions of live stock and grain were broadened. Provision was made for making loans to farmers on various types of security, to complement the Farm Improvement Loans Act, and to fishermen





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on the security of vessels, equipment, supplies and products. Provision was also made to enable a borrower to give a pledge at the beginning of each borrowing season which would cover all existing and all after acquired property of the kind described in the pledge and would apply to all loans made under the credit. References: S2 and S86 to S90.

1954. Several definitions were altered for the purpose of enlarging the list of products to be included. Seed potatoes was added as eligible security for loans to farmers. Changes were made in the procedure relating to registration of notices of intention to permit cancellation if not renewed within five years. References: S2 and S86 to S90.



THE QUEBEC SAVINGS BANKS ACT

Comments on some of its more important features and information regarding legislation on similar matters in some other countries.

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HISTORY

1  
2 1. Section 91 of the British North America  
3 Act provides that the exclusive legislative authority  
4 of the Parliament of Canada extends, inter alia, to  
5 all matters coming within the head of Savings Banks.  
6 The two savings banks now in existence were incorp-  
7 orated by special Act of the Provincial Parliament  
8 prior to Confederation, the Montreal City and District  
9 Savings Bank in 1862 and La Banque d'Economie de  
10 Quebec, The Quebec Savings Bank, in 1866. Prior  
11 to incorporation they both had been in operation for  
12 some years, the Montreal bank having commenced  
13 business in 1846 and the Quebec bank in 1848.

14 2. In 1871 Parliament enacted legislation  
15 which applied to all savings banks previously  
16 incorporated and provided that a savings bank might  
17 either

18 (1) transfer its assets and liabilities to the  
19 Canadian Government,

20 (2) transfer its assets and liabilities to a  
21 chartered bank, or

22 (3) be granted a charter by the Governor  
23 General and carry on business thereunder.

24 These two banks chose the latter alternative and  
25 their charters originally granted for ten years have  
26 been continued in force from time to time by statute.

27 3. It should be noted that these banks were  
28 newly incorporated by the granting of the federal  
29 charters. Although the charters were issued  
30 pursuant to statutory authority, the corporations





1 were brought into being by Act of the Governor  
2 General and not by the statute. In this respect  
3 incorporation was similar to the incorporation of  
4 a company under the Dominion Companies Act by  
5 letters patent. It is characteristic of a corporation  
6 so formed that it has all the rights, powers and  
7 capacity of an individual.

8 4. This attribute differs from a so-called  
9 statutory corporation which is created either by  
10 special Act, such as a chartered bank, or in  
11 accordance with a general Act which brings the  
12 corporation into being upon compliance with the  
13 provisions of the general Act. Such a statutory  
14 corporation in law has not the same capacity as a  
15 corporation created by charter, as its capacity is  
16 confined to that conferred on it by the statute.  
17 Any acts of the corporation outside the scope of  
18 the statute are void. On the other hand a chartered  
19 corporation, while it may be prohibited from doing  
20 certain acts, can do the act although it may thereby  
21 incur a penalty.

22 5. For the purpose of placing the savings  
23 banks, insofar as possible, in the same statutory  
24 position as the chartered banks, the entire Quebec  
25 Savings Banks Act was rewritten in 1954. The  
26 provisions of the Act cover and, by means of section  
27 7, override the provisions of the bank charters,  
28 and the Act provides penalties for violations.  
29 A large majority of the sections in the 1954 Act  
30 have little history in previous Acts. Wherever





1 appropriate, they are the same as or similar to  
2 sections in the Bank Act.

3  
4 INCORPORATION OF BANKS

5 6. There is no provision in this Act,  
6 similar to those in the Bank Act, for the incorpor-  
7 ation of further banks of this type and there are  
8 no other savings banks of this kind in Canada.  
9 The Act provides that the Montreal City and District  
10 Savings Bank may open branches and carry on business  
11 in what is approximately the western half of the  
12 Province of Quebec and La Banque d'Economie de  
13 Quebec, The Quebec Savings Bank, in the remainder  
14 of the Province.

15 7. The Quebec Savings Banks Act of 1954  
16 continued the two charters but the power to carry  
17 on the business of banking expires in July 1964  
18 if not renewed prior to that time if Parliament  
19 is sitting during the month of June.

20  
21 DIRECTORS

22 8. The Act provides that the bank shall be  
23 under the management of a board of directors elected  
24 by the shareholders at each annual general meeting.  
25 If a vacancy occurs during the year, it may be  
26 filled by the remaining members of the board. There  
27 are no qualifying restrictions regarding nationality  
28 or age.

29 9. Directors may make by-laws with respect  
30 to any matter except an increase in their own







remuneration, but where any such by-law provides for a matter that may be the subject of a shareholders' by-law, it must be ratified at the next annual general meeting or thereafter cease to have effect.

#### CAPITAL ACCOUNTS

10. The Act provides that

- (1) The authorized capital of the Montreal City and District Savings Bank is \$2,000,000 divided into shares of \$10 par value each and that of La Banque d'Economie de Quebec, The Quebec Savings Bank, is \$1,000,000 divided into shares of \$10 par value each.
- (2) The authorized capital may be increased by means of a shareholders' by-law if approved by the Treasury Board.
- (3) The directors may issue new shares within the limits of the authorized capital and these shares must first be offered to the then shareholders on a pro rata basis except that
  - (a) the price of the share shall be not less than the par value of \$10 each and any premium no greater in relation to the par value than the rest account is in relation to the paid-up capital stock, and
  - (b) no share need be offered to a resident





1 of a country where the offer should not  
2 be made unless information other than that  
3 in the last financial statement is  
4 required.

5 (4) Shares are transferable only on the stock  
6 register of the bank.

7 The authorized capital of each bank is fully  
8 subscribed and paid up.

9 11. Section 59A, enacted in 1957, permits  
10 investment, not otherwise authorized by the Act,  
11 in any type of securities and shares of Canadian  
12 corporations but limits the aggregate amount of  
13 these investments to 50 percent of the shareholders'  
14 equity. The limit, if any, on other investments  
15 is related to deposit liabilities. There is no  
16 statutory limitation on investment in bank premises.

17  
18 FINANCIAL STATEMENTS

19 12. Section 45 deals with the annual  
20 financial statements which the bank must submit to  
21 its shareholders and was almost completely revised  
22 in 1954 to conform with modern accounting practice.  
23 Section 83 requires the bank to submit monthly  
24 statements of assets and liabilities to the Minister  
25 of Finance and these are published in the Canada  
26 Gazette. The form of the statement of assets and  
27 liabilities which appears as Schedule A in the Act  
28 was amended by Chapter 12 of the Statutes of 1956-57  
29 to require the bank to state all securities of the  
30 governments of Canada and the provinces at not more





1 than amortized value. Other securities are stated  
2 at not more than market value in the annual and  
3 monthly reports. A copy of the April 30, 1962  
4 statement of the banks is submitted on page A. 64  
5 following.





STATEMENT OF THE ASSETS AND LIABILITIES  
OF THE QUEBEC SAVINGS BANKS

as at April 30, 1962

COMPILED FROM RETURNS MADE PURSUANT TO SECTION 83 OF THE QUEBEC SAVINGS BANKS ACT

	The Montreal City and District Savings Bank	La Banque d'Economie de Québec, The Quebec Savings Bank	Total
	\$	\$	\$
<b>ASSETS</b>			
1. Notes of and deposits with Bank of Canada and deposits with chartered banks in Canadian currency.....	31,410,917	3,228,381	34,639,298
2. Other cash, deposits with and balances due from other banks.....	9,095,476	1,980,014	11,075,490
3. Government of Canada direct and guaranteed securities, not exceeding amortized value.....	31,897,376	5,900,745	37,798,121
4. Canadian provincial government direct and guaranteed securities, not exceeding amortized value.....	67,549,035	17,783,707	85,332,742
5. Canadian municipal and school corporation securities, not exceeding market value.....	28,894,228	13,633,692	42,527,920
6. Other Canadian securities and shares, not exceeding market value.....	18,885,166	7,701,880	26,587,046
7. Securities and shares, other than Canadian, not exceeding market value.....	9,753,225		9,753,225
8. Mortgages and hypothecs insured under the National Housing Act, 1954.....	63,471,432	7,447,875	70,919,307
9. Other mortgages and hypothecs, less provision for estimated loss.....	10,520,881	1,030,805	11,551,686
10. Loans otherwise secured, less provision for estimated loss.....	8,528,562	1,085,671	9,614,233
11. Loans without security, less provision for estimated loss.....	180,000	83,000	263,000
12. Poor Fund or Charity Fund investments.....	7,000,000	1,551,559	8,551,559
13. Bank premises at cost, less amounts written off.....	87,566	91,084	178,650
14. Other assets.....			
Total Assets.....	287,273,864	61,518,413	348,792,277
<b>LIABILITIES</b>			
1. Deposits by Government of Canada.....	916,510		916,510
2. Deposits by Canadian provincial governments.....		5,548,684	5,548,684
3. Deposit liabilities to the public.....	275,060,878	50,398,538	325,459,416
4. Advances from Bank of Canada, secured.....			
5. Advances from chartered banks, secured.....		1,925,710	1,925,710
6. Poor Fund or Charity Fund Trust.....	180,000	83,000	263,000
7. Other liabilities.....	414,351	46,290	460,641
8. Capital paid up.....	2,000,000	1,000,000	3,000,000
9. Rest account.....	8,500,000	2,000,000	10,500,000
10. Undivided profits.....	202,125	516,191	718,316
Total Liabilities.....	287,273,864	61,518,413	348,792,277

DEPARTMENT OF FINANCE,  
OTTAWA, May 15, 1962

K. W. TAYLOR,  
Deputy Minister of Finance.



BANK INSPECTION

13. One of the provisions of the charters granted in 1871 authorized the bank to open branches within the district where it was empowered to operate. At December 31, 1961 the two banks had 72 branches, all in the Province of Quebec, and on their books recorded over \$335 million of assets consisting mostly of cash, securities, mortgages and loans. Here, as with the chartered banks, the inspection is very comprehensive and is carried out by the three agencies, bank officials, shareholders' auditors and government officials.

Internal Supervision

14. Each bank maintains an inspection staff supervised by an experienced chief inspector and periodic examinations of all branches are made annually. In addition the branch reports reach the chief inspector and are carefully scrutinized.

Shareholders' Audit

15. Legislation to make shareholders' audits compulsory was first enacted in the Quebec Savings Banks Act of 1913. There were no stipulations regarding training, ability or professional standing of the appointees. In 1954 several amendments were made for the purpose of improving and strengthening the auditing and reporting provisions, many of them similar to those in the Bank Act. Some of the more important ones are as follows:

- (1) Only experienced members in good standing of an accounting institute incorporated





1 by the legislature of the Province of  
2 Quebec may act as auditors. The present  
3 incumbents are all practising chartered  
4 accountants who each have had many years  
5 of auditing experience.

6 (2) The Minister of Finance has the right to  
7 declare any person ineligible for  
8 appointment or to cancel the appointment  
9 of a bank auditor without accounting for  
10 his action.

11 (3) Two eligible accountants, not members  
12 of the same firm, must be appointed by  
13 the shareholders to audit the affairs of  
14 the bank.

15 (4) The Minister may enlarge or extend the  
16 scope of the audit or direct that another  
17 or particular procedure be established,  
18 and he may require the auditors to report  
19 to him on any matter in respect of which  
20 he desire information.

21 16. The auditors make an examination of the  
22 cash and investment securities at head office of  
23 the bank where most of these assets are carried.  
24 They also verify the collateral security held  
25 against loans. In addition it is customary to  
26 review the internal inspection reports to satisfy  
27 themselves that the examination of the branches is  
28 adequate. They have full access to all books and  
29 records and are entitled to receive from the officers  
30 of the bank all the information they may require for  
the purposes of their audit.







1 Government Inspection

2 17. The Act of 1934, for the first time,  
3 provided for inspection of these banks by the  
4 Inspector General of Banks. Previously the 1913  
5 Act had authorized the Minister to employ auditors  
6 to make a special examination of a bank if he so  
7 wished.

8 18. The duties of the Inspector General  
9 under this Act are similar to those specified in  
10 the Bank Act. He is required from time to time,  
11 but not less frequently than once in each calendar  
12 year, to make or cause to be made such examination  
13 and enquiry into the affairs of each bank as he may  
14 deem to be necessary or expedient for the purpose of  
15 satisfying himself that the provisions of the Act  
16 having reference to the safety of the creditors  
17 and shareholders are being duly observed and that  
18 the bank is in a sound financial position. At the  
19 conclusion of each such examination, he is required  
20 to report thereon to the Minister of Finance.

21 19. The banks submit returns to the Minister  
22 of Finance on many pertinent matters and all of these  
23 come before the Inspector General for review. Among  
24 the returns received are monthly statements of assets  
25 and liabilities, statements of cash and additional  
26 reserves, valuations of security portfolios and  
27 statements of earnings and expenses. From the  
28 various reports and returns received from each  
29 bank a considerable amount of pre-examination data  
30 is compiled and the actual time which would otherwise





1 be spent at the head office is reduced accordingly.  
2 In conducting the examinations, unnecessary dupli-  
3 cation of work is avoided when that work has already  
4 been efficiently carried out by bank inspectors or  
5 shareholders' auditors. The examinations do not  
6 embrace a physical check of cash or collateral or  
7 securities on hand, as this verification is already  
8 adequately covered by the latter.

9 20. The banks are permitted by the Income  
10 Tax Act to set aside out of taxable income inner  
11 reserves to meet losses on loans and other invest-  
12 ments to the extent that the Minister of Finance may  
13 consider reasonable, having regard to all the  
14 circumstances. Rules for the determination of the  
15 maximum permitted reserves in each fiscal year are  
16 issued by the Minister and, following the annual  
17 examination of a bank, the Inspector General reports  
18 to the Minister whether its reserves are within the  
19 prescribed limits in order that the Minister may so  
20 inform the Minister of National Revenue as required  
21 by the Quebec Savings Banks Act.

22 21. Each savings bank is required to maintain  
23 at all times cash and additional reserves, the  
24 contents of which are described on page A.76. Monthly  
25 returns are made to the Minister and to the Bank of  
26 Canada showing the status of these reserves and the  
27 Act requires the Inspector General to make an  
28 examination of the books and records of each bank  
29 to satisfy himself that the returns are correct and  
30 to report thereon to the Minister and to the Bank of  
Canada.





22. As noted in the submission on the Bank Act, the degree of inspection of banks varies greatly in different parts of the world. It would appear, however, that the triple examination procedure in effect here is as complete as any that has come to our attention.







INNER RESERVES

23. The banks maintain three types of inner reserves, namely,

- (1) Specific reserves, which are required by the Quebec Savings Banks Act to provide for estimated losses on loans and for market depreciation of securities other than those of Canada and the provinces,
- (2) Contingency reserves, which are for the purpose of meeting losses in excess of those covered by specific reserves which may occur but which are not apparent at the time, and
- (3) Tax Paid reserves, on which no further income taxes are exigible and the amount of which is in effect undisclosed rest or surplus.

24. The wording of section 52 of the Quebec Savings Banks Act is the same as that of section 68 of the Bank Act to which reference is made on page A.25 of the submission in respect of that Act and reads as follows:

"(1) Where in the opinion of the Minister an amount set aside or reserved by any bank out of income, either by way of write-down of the value of assets or appropriation to any contingency reserve or contingent account for the purpose of meeting losses on loans, bad or doubtful debts, depreciation in the value of assets other than bank premises or other





1 contingencies, is in excess of the reasonable  
2 requirements of the bank having regard to all  
3 the circumstances, the Minister shall notify  
4 the Minister of National Revenue of the amount  
5 so set aside and of the amount of such excess.

6 (2) Nothing in subsection (1) shall be  
7 construed to give the Minister any jurisdiction  
8 over the discretion of the directors of the bank  
9 with regard to amounts set aside, reserved or  
10 transferred to any reserve or other account  
11 from income upon which taxes have been assessed  
12 under any Act of the Parliament of Canada  
13 imposing a tax upon or in respect of income."

14 25. By definition subsection (1) refers to  
15 specific and contingency reserves and subsection (2)  
16 refers to the tax paid reserves. Rules of the Minister  
17 of Finance for the determination of the prescribed  
18 aggregate reserves of a bank under subsection (1)  
19 are issued annually. A copy of the Rules for the  
20 fiscal years ended in 1961 is submitted on page A.73  
21 following, from which it will be noted that the  
22 prescribed aggregate of the non-taxed reserves of  
23 a bank for that year was an amount equal to 5 percent  
24 of its related assets less specific reserves in  
25 respect of these assets. This amounted to approx-  
26 imately \$5.5 million for the two banks after  
27 deduction of specific reserves.

28 26. In the United States a savings and loan  
29 association or a mutual savings bank is allowed  
30 reserves of 12 percent of its deposits. If this





*Nethercut & Young*

*Toronto, Ontario*

A. 72

1 formula were applied to the Quebec savings banks  
2 at their last fiscal year ends, it would result in  
3 a permitted reserve far greater than that now  
4 prescribed.







RULES FOR THE DETERMINATION OF THE INNER RESERVES  
OF THE QUEBEC SAVINGS BANKS

Issued by the Minister of Finance  
pursuant to sections 9 and 11(4) of the Income Tax  
Act

September 13, 1961

1. THE INNER RESERVES of a bank, for the purposes of these Rules, include all of its unpublished reserves other than the Bank Premises Depreciation Reserves.

2. THE TAX PAID RESERVES of a bank include all its inner reserves upon which the taxes exigible by the Government of Canada have been assessed.

3. THE SPECIFIC RESERVES of a bank include all its inner reserves against particular securities and loans that are required to reduce the book value of the relative assets to estimated realizable values.

4. THE LOSS EXPERIENCE of a bank includes

(a) in respect of the securities described in Rule 6(a), all provisions for specific reserves and reversals of these provisions; and

(b) in respect of the loans, mortgages and hypothecs described in Rule 6(b), all losses and recoveries of losses, provisions for specific reserves and reversals of these provisions.

The net amount of the annual loss experience is to be transferred to the Contingency Reserves at the end of the fiscal year and added thereto or deducted therefrom as the case may be.

5. THE CONTINGENCY RESERVES of a bank include all its remaining inner reserves and the prescribed aggregate of these reserves, hereinafter referred to as PAR,





1 is an amount equal to 5% of the aggregate book value  
2 of the assets described in Rules 6 less an amount  
3 equal to the total of all specific reserves in  
4 respect of these assets up to a maximum deduction  
5 of 5% of their aggregate book value.

6 6. THE ASSETS referred to in Rule 5 for the calcu-  
7 lation of PAR are

8 (a) Securities other than 1) those of or  
9 guaranteed by the Government of Canada or a  
10 Canadian province, 2) those of or guaranteed  
11 by the Government of the United States or the  
12 United Kingdom issued for a term of less than  
13 one year and 3) shares of capital stock of a  
14 corporation.

15 (b) Loans, mortgages and hypothecs other than  
16 1) day-to-day loans in Canada, 2) those to or  
17 guaranteed by the Government of Canada, the  
18 United States, the United Kingdom or a Canadian  
19 province, 3) those on the security of Canada  
20 Savings Bonds at the agreed rate for the issue,  
21 including those to employers under a payroll  
22 savings plan, 4) those to or guaranteed by other  
23 banks, 5) those which are not bearing interest  
24 because of a contra deposit, 6) those to  
25 municipalities or charitable organizations which  
26 are offset by a contra deposit bearing the same  
27 rate of interest, 7) those to a corporation  
28 controlled by the bank, and 8) mortgages and  
29 hypothecs insured under the National Housing  
30 Act, 1954.





1        7.        If the total of the Contingency Reserves, after  
2 making the transfer pursuant to Rule 4, is greater  
3 than PAR at the end of a fiscal year, one-fifteenth  
4 of the surplus is to be deducted from the Reserves  
5 and added to the taxable earnings of the fiscal year.

6        8.        If the total of the Contingency Reserves, after  
7 making the transfer pursuant to Rule 4, is less than  
8 PAR at the end of a fiscal year, any part of the  
9 deficiency may be extinguished by a transfer from  
10 the taxable earnings of the fiscal year.







CASH AND ADDITIONAL RESERVES

27. Section 55 deals with cash and additional reserves, the basis of which has been altered several times in the past, the latest amendment being in 1957. The pertinent subsections now read as follows:

"(1) The bank shall at all times maintain a cash reserve in the form of notes of or deposits with the Bank of Canada or of deposits with a chartered bank in Canadian currency and such reserve shall be not less than five percent of such of its deposit liabilities as are payable in Canadian currency.

(2) The bank shall at all times maintain a reserve, in addition to that required by subsection (1), equal to at least fifteen percent of such of its deposit liabilities as are payable in Canadian currency in the form of

(a) notes of or deposits with the Bank of Canada or of deposits with a chartered bank in Canadian currency, or

(b) securities of or guaranteed by the Government of Canada or of a province."

28. As almost all of the deposits payable in Canadian currency are in practice subject to chequing and on a demand basis, no attempt has been made to set different reserve percentage rates.

29. It is not the practice in most other countries to permit chequing on interest bearing personal savings deposit accounts and no member bank





1 of the Federal Reserve system in the United States  
2 may allow interest on deposits payable on demand.  
3

4 INVESTMENTS

5 30. Section 58, section 59 as amended in  
6 1957, section 59A enacted in 1957 and section 60,  
7 copies of which appear as an Appendix at pages A.81  
8 to A.84 set out in detail the investment powers of  
9 the savings banks. With the provisions in the so-  
10 called "basket clause" in section 59A the banks are  
11 not greatly restricted in this field at present.  
12

13 LOANS AND ADVANCES

14 31. Sections 61, 62 and sections 63 and 64  
15 as amended in 1957, copies of which appear as an  
16 Appendix at pages A.85 to A.88, detail the lending  
17 powers of the savings banks. Section 64 authorizes  
18 the bank to lend money on the security of first  
19 mortgages on residential property in an amount that,  
20 together with any purchases of these mortgages under  
21 section 60, does not exceed 40 percent of its deposit  
22 liabilities.

23 32. Subsection (4) of section 64 as amended  
24 in 1957 provides that the 6 percent per annum  
25 limitation on the interest rate on loans and advances  
26 specified in section 71 does not apply to those made  
27 under this section on the security of first mortgages.

28 33. In most countries the laws relating to  
29 savings banks authorize the lending of money on the  
30 security of mortgages. Those of New York State





(as an example) permit investment in mortgages

(1) to an amount not exceeding 60 percent of the  
appraised value of any real property, or

(2) to an amount not exceeding 75 percent of the  
appraised value of improved residential  
property

but the total of these investments must not exceed  
65 percent of the assets of the savings bank.

LOAN INTEREST AND CHARGES

34. Provisions limiting the maximum rate of  
interest or discount that a savings bank may charge  
on a loan or advance first appeared by an amendment  
to the Act in 1948 when the rate was set at 6  
percent to agree with that of the chartered banks,  
and the same rate is continued in section 71 of  
the 1954 Act.

35. Subsection (2) of section 73 of the  
Act provides that the bank may make a charge for  
the keeping of an account if express agreement is  
received from the customer. Both the savings banks  
have personal loan plans under which they obtain  
further gross revenue in addition to the statutory  
interest or discount charged on the loan.

36. In most European countries there are no  
limits on the rate of interest a savings bank may  
charge on a loan or advance other than the normal  
laws of usury. Some of the United States have  
limits on interest rates. The Savings Bank Law  
of New York State (as an example) provides for a







1 maximum interest or discount rate of 6 percent per  
2 annum.

3  
4 DEPOSIT INTEREST

5 37. The rates allowed on personal savings  
6 deposits have for many years been the same as those  
7 paid by the chartered banks. Changes in the latter  
8 are listed in paragraph 69 of the submission with  
9 respect to the Bank Act. The present rate is 2 3/4  
10 percent on minimum quarterly balance.

11 38. As previously noted, most of these  
12 deposits are subject to chequing privileges. This  
13 practice is rarely found in the savings banks of  
14 other countries.

15  
16 UNCLAIMED BALANCES

17 39. The banks are required by section 74  
18 of the Act to pay to Bank of Canada in trust for  
19 the rightful owner an amount equal to all deposits,  
20 bills of exchange and other like instruments payable  
21 in Canadian currency and unclaimed for a period of  
22 ten years. If an amount is for less than \$10 and  
23 remains unclaimed after thirty years, it is  
24 prescribed and paid to the Receiver General of  
25 Canada for the Consolidated Revenue Fund.

26  
27 RETURNS

28 40. Sections 83 to 90 of the Act enumerate  
29 the returns that the banks are required to make to  
30 the Minister, namely,





- (1) A monthly return of assets and liabilities
- (2) A monthly return of cash and additional reserves
- (3) An annual return of unclaimed balances in Canadian currency
- (4) An annual return of interest charges
- (5) An annual return of shareholders.

41. Section 91 of the Act authorizes the Minister to obtain such other information in such form as he may require and there are supplementary returns such as an annual statement of investment securities as well as explanatory information submitted on request from time to time.





APPENDIX

SECTIONS 58 TO 60

QUEBEC SAVINGS BANKS ACT

58. The bank may invest in

- (a) securities of or guaranteed by the Government of Canada or of a province;
- (b) securities of or guaranteed by the Government of the United Kingdom or of any colony, dependency or protectorate of the United Kingdom;
- (c) securities of or guaranteed by the government of any other country of the British Commonwealth or of any colony, dependency or protectorate of any such country;
- (d) securities of or guaranteed by the Government of the United States of America or of any state thereof;
- (e) securities of or guaranteed by a municipal corporation in Canada;
- (f) securities of a school corporation in Canada that derives its revenues from rates or taxes levied by it or on its behalf;
- (g) securities of an ecclesiastical or religious corporation incorporated in Canada;
- (h) securities of a fabrique de paroisse or syndic issued under the Parish and Fabrique Act of the Province of Quebec;
- (i) securities of a corporation incorporated for the purpose of operating a hospital or sanitarium in the Province of Quebec; and





(j) securities issued to finance the purchase of transportation equipment for a railway company incorporated in Canada, or for a railway company owned or controlled by a railway company so incorporated, if the securities are fully secured by

(i) an assignment of the equipment to, or the ownership thereof by, a trustee, and

(ii) a lease or conditional sale of the equipment by the trustee to the railway company;

if the securities are not in default in respect of either principal or interest.

59. The bank may invest in

(a) the securities and preferred shares of a corporation incorporated in Canada

(i) the common shares of which are listed on a recognized stock exchange, or more than one-half the common shares of which are owned by a corporation incorporated in Canada whose common shares are listed on a recognized stock exchange,

(ii) that has, in each of its last five financial years ended less than one year before the date of the investment, paid in cash, out of income earned in the year of payment,

(A) a dividend on all its outstanding





capital stock, or

(B) interest in full upon all of its  
outstanding securities, and

(iii) that has an unimpaired paid-up capital  
and earned surplus in excess of five  
hundred thousand dollars;

(b) the shares of a chartered bank that has, in  
each of its last five financial years ended  
less than one year before the date of the  
investment, paid in cash, on all its out-  
standing capital stock, a dividend out of  
income earned in the year of payment; and

(c) any other securities approved by the Treasury  
Board;

if the aggregate value of the investments on the  
books of the bank under this section, together  
with the market value of the proposed investment,  
does not exceed fifteen per cent of its deposit  
liabilities.

59A. The bank may invest in the securities and shares  
of a corporation incorporated in Canada, other than  
one mentioned in section 58 or 59, the securities  
of which are not in default in respect of either  
principal or interest, if the aggregate value of  
the investments on the books of the bank under  
this section, together with the market value of  
the proposed investment, does not exceed fifty  
per cent of the paid-up capital and rest account  
of the bank.





1 60. The bank may, subject to this Act, invest in  
2 (a) mortgages and hypothecs upon the security  
3 of which the bank may lend money and make  
4 advances under section 64; and  
5 (b) mortgages and hypothecs upon the security  
6 of which the bank may lend money and make  
7 advances under the National Housing Act, 1954.  
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APPENDIX

SECTIONS 61 to 64

QUEBEC SAVINGS BANKS ACT

61. The bank may lend money and make advances to any person if the bank takes as security for the repayment of the loan

(a) any of the securities mentioned in section 58, the market value of which, at the time the loan is made, is not less than the amount of the loan;

(b) the shares of a chartered bank or the securities or shares of a corporation other than one mentioned in section 58, the market value of which, at the time the loan is made, is not less than one hundred and twenty per cent of the amount of the loan; or

(c) a life insurance policy, the cash surrender value of which, at the time the loan is made, is not less than the amount of the loan,

and the bank takes the security with authority to sell it or realize thereon.

62. The bank may lend money and make advances without security to the Government of Canada or a province.

63. The bank may lend money and make advances without security

(a) to a municipal corporation in Canada;

(b) to a school corporation in Canada that derives its revenues from rates or taxes levied by it or on its behalf;





APPENDIX

- (c) to an ecclesiastical or religious corporation incorporated in Canada;
- (d) to a fabrique de paroisse or syndic that is subject to the Parish and Fabrique Act of the Province of Quebec;
- (e) to a corporation incorporated for the purpose of operating a hospital or sanitarium in the Province of Quebec;
- (f) to a corporation incorporated in Canada, in an amount that, together with the amount owing by the corporation to the bank in respect of any other loan under this section, does not, at the time the loan is made, exceed the unimpaired paid-up capital and earned surplus of the corporation, if
- (i) the loan is authorized by resolution of the board of directors of the bank,
  - (ii) the corporation has an unimpaired paid-up capital and earned surplus in excess of five hundred thousand dollars, and
  - (iii) the corporation has, in each of its last five financial years ended less than one year before the date of the loan, paid in cash, on all its outstanding capital stock, a dividend out of income earned in the year of payment; or
- (g) to any individual in an amount that, together with the amount owing by the individual to





1 the bank in respect of any other loan under  
2 this section, does not, at the time of the  
3 loan, exceed five thousand dollars;

4 if the aggregate outstanding amount of the loans  
5 made by the bank under this section, together  
6 with the proposed loan, does not exceed five  
7 per cent of its deposit liabilities.

8 64. (1) The bank may lend money and make advances  
9 on the security of a first mortgage or  
10 hypothec on improved real or immovable  
11 residential property in Canada if

12 (a) the loan is authorized by a resolution  
13 of the board of directors of the bank,  
14 and

15 (b) the amount of the loan does not exceed  
16 the lesser of

17 (i) sixty per cent of the value of the  
18 real or immovable property on which  
19 the mortgage or hypothec is taken,  
20 or

21 (ii) one hundred thousand dollars,

22 and the aggregate amount outstanding of

23 (c) loans made by the bank under this section,

24 (d) loans made by the bank under the

25 National Housing Act, 1954, and

26 (e) mortgages and hypothecs invested in by

27 the bank under section 60,

28 together with the proposed loan, does not

29 exceed forty per cent of its deposit

30 liabilities.







APPENDIX

(2) In this section "improved real or immovable residential property" means land or immovable property upon which there is situate a building that constitutes a permanent improvement to the property or on which there is such a building in the process of construction, if at least one-half of the floor space of the building is used, or in the case of a building in the process of construction, is to be used, for residential purposes.

(3) This section does not limit the authority of the bank to accept a mortgage or hypothec of any amount as part payment of the sale price of real or immovable property sold by the bank.

(4) The provisions of section 71 do not apply to loans and advances made under this section.





ADDENDA TO THE SUBMISSION

(May, 1962)

to the

ROYAL COMMISSION ON BANKING AND FINANCE

with respect to

THE BANK ACT

and

THE QUEBEC SAVINGS BANKS ACT

DEPARTMENT OF FINANCE,

OTTAWA, January, 1963.

C. F. ELDERKIN,

Inspector General of  
Banks.





The following notes and tables provide the latest available information on certain matters referred to in the submission of May, 1962 at the undernoted pages and paragraphs.

<u>Page</u>	<u>Paragraph</u>	
-------------	------------------	--

A. 93	-	A revised statement of additions by chartered banks to rest account and paid-up capital is appended as Table 1.
-------	---	---

A. 94	-	A statement of approximate asset and liability percentages of chartered banks and United States insured commercial banks at December 31, 1961 is appended as Table 2.
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A. 95	-	A statement of earnings and expenses and other information of the chartered banks for the financial years ending in 1962 is appended as Table 3.
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A. 97	-	A statement of approximate earnings and expenses percentages of chartered banks and United States insured commercial banks for 1961 is appended as Table 4.
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A. 14	22	At November 30, 1962 the eight banks had 5,488 branches of which 164 were outside Canada, and total assets of almost \$20 billion.
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<u>Page</u>	<u>Paragraph</u>
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A. 20	32	In 1962 more than 3,200 reports covering aggregate outstanding loans of over \$4,100 million were received from the banks.
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A. 26	43	For the chartered banks as a whole, the permitted contingency reserves at the 1962 fiscal year ends amounted in the aggregate to \$326 million or 2.951 percent of related assets after deduction of specific reserves from the maximum reserves allowed.
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A. 27	45	The United States allows a general reserve which includes any specific reserves on loans if a bank elects to adopt this method for income tax purposes.
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A. 29	-	The Rules for the determination of the inner reserves of a chartered bank for the fiscal year ended in 1962 prescribed a maximum reserve percentage of 3.624.
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The formula in use would produce a maximum reserve percentage of 3.504 for the 1963 fiscal year.

A. 34	52	At November 30, 1962 the chartered banks had 5,324 branches in Canada and 164 elsewhere.
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1	Page	Paragraph	
2	A. 38	-	A comparative classification of
3			loans of the chartered banks in
4			Canadian currency at September 30,
5			1961 and 1962 is appended as
6			Table 5.
7	A. 42	69	The rate of interest paid by the
8			chartered banks on minimum
9			quarterly balances of personal
10			savings deposits was increased
11			to 3 percent from July 1, 1962.
12			- - - - -
13			
14	A. 64	-	A statement of the assets and
15			liabilities of the Quebec savings
16			banks at November 30, 1962 is
17			appended as Table 6.
18	A. 65	13	At November 30, 1962 the Quebec
19			savings banks had 75 branches and
20			over \$363 million of assets.
21	A. 79	37	The rate of interest paid by
22			Quebec savings banks on minimum
23			quarterly balances of personal
24			savings deposits was increased
25			to 3 percent from July 1, 1962.
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STATEMENT OF ADDITIONS BY BANKS TO REST  
ACCOUNT AND PAID-UP CAPITAL DURING THE  
YEARS 1954 TO 1962 AND TOTALS FOR PRIOR  
YEARS

(Amounts in thousands of dollars)

	Rest Account			Paid-up Capital
	From Profits <sup>1</sup>	From Issue of Capital Stock	Total	
Bank of Montreal	39,150	50,850	90,000	24,750
The Bank of Nova Scotia	22,520	36,480	59,000	12,000
The Toronto-Dominion <sup>2</sup> Bank	21,200	34,800	56,000	17,000
The Provincial Bank of Canada	6,800	6,192	12,992	3,995
Canadian Imperial Bank of Commerce <sup>3</sup>	76,570	60,430	137,000	29,680
The Royal Bank of Canada	90,460	82,611	173,071	31,528
Banque Canadienne Nationale	19,000	9,000	28,000	3,000
The Mercantile Bank of Canada	<u>600</u>	<u>400</u>	<u>1,000</u>	<u>4,000</u>
All banks, 1954-1962	276,300	280,763	557,063	125,953
All banks, prior years	<u>138,510</u>	<u>116,490</u>	<u>255,000</u>	<u>151,000</u>
Totals	<u>414,810</u>	<u>397,253</u>	<u>812,063</u>	<u>276,953</u>

Notes 1 Including re-transfers from inner reserves.

2 Including figures of The Bank of Toronto and  
The Dominion Bank prior to amalgamation.

3. Including figures of The Canadian Bank of  
Commerce, Imperial Bank of Canada and Barclays  
Bank (Canada) prior to amalgamations.







APPROXIMATE ASSET AND LIABILITY PERCENTAGES  
AS AT DECEMBER 31, 1961  
CHARTERED BANKS AND U.S. INSURED COMMERCIAL BANKS

	<u>Canada</u>	<u>United</u>
	<u>%</u>	<u>States<sup>1</sup></u>
<u>Assets</u>		
Cash assets and due from banks	15.9	18.0
Federal government securities	19.8	24.3
Provincial or State and municipal securities	3.0	7.3
Other securities	6.0	1.3
Loans and discounts	52.0	46.6
All other assets	<u>3.3</u>	<u>2.5</u>
	<u>100.0</u>	<u>100.0</u>
<u>Liabilities</u>		
Federal government deposits	3.1	2.6
Deposits and balances due other banks	4.8	6.4
Demand deposits, other	28.7 <sup>2</sup>	49.1
Time and savings deposits, other	55.7 <sup>2</sup>	30.6
All other liabilities	2.1	2.8
Capital funds	<u>5.6</u>	<u>8.5</u>
	<u>100.0</u>	<u>100.0</u>

Notes 1 Source: Annual report of the Federal  
Deposit Insurance Corporation for the  
year ended December 31, 1961.  
Figures are adjusted in some cases to fit  
Canadian titles.

2 Partially estimated.



Table 3

## THE CHARTERED BANKS OF CANADA

EARNINGS, EXPENSES AND OTHER INFORMATION  
FOR THE FINANCIAL YEARS ENDING IN 1962

(Dollar amounts in millions)

Compiled from returns made pursuant to section 106 of the Bank Act

CURRENT OPERATING EARNINGS	\$
Interest and discount on loans.....	611.5
Interest, dividends and trading profits on securities <sup>1</sup> .....	211.3
Exchange, commission, service charges and other current operating earnings.....	<u>154.0</u>
Total current operating earnings.....	<u>976.8</u>
CURRENT OPERATING EXPENSES	
Interest on deposits.....	355.3
Remuneration to employees.....	260.9
Contribution to pension funds.....	13.6
Provision for depreciation of bank premises.....	22.4
Other current operating expenses.....	<u>135.4</u>
Total current operating expenses.....	<u>787.6</u>
Net current operating earnings <sup>2</sup> .....	189.2
Add: Capital profits and non-recurring items <sup>3</sup> .....	2.0
Less: Provision for losses and additions to inner reserves, net <sup>4</sup> .....	( 24.7)
Less: Provision for income taxes <sup>5</sup> .....	<u>( 84.7)</u>
Leaving for dividends and shareholders equity.....	<u>81.8</u>
Of which: Dividends to shareholders.....	60.3
Additions to shareholders equity.....	21.5

ADDITIONS TO SHAREHOLDERS EQUITY AND INNER RESERVES  
TWENTY-FIVE FINANCIAL YEARS ENDING IN 1962

SHAREHOLDERS EQUITY	\$
Undivided Profits	
From operating earnings, net after transfers to rest account.....	- 0.8
Rest Account	
From operating earnings and undivided profits.....	179.6
From retransfers from inner reserves.....	210.0
From premium on new shares.....	288.7
Capital Paid Up	
From issue of new shares.....	<u>131.5</u>
Net addition to shareholders equity.....	<u>809.0</u>
INNER RESERVES	
From operating earnings and capital profits.....	586.4
Less: Amount retransferred to rest account.....	(210.0)
Less: Losses on loans and investments <sup>1,6,#</sup> .....	<u>(170.1)</u>
Net addition to inner reserves.....	<u>206.3</u>
# Ratio of average annual loss experience to related assets.....	.146 %





2.

NOTES

- 1 Realized profits and losses on disposal of securities are included in operating earnings.
- 2 Before provision for income taxes, losses and transfers to inner reserves.
3. Profits and losses on sale of fixed assets and adjustments relating to prior years.
- 4 After amounts retransferred to rest account.
- 5 Includes income taxes on taxable portion of additions to and amounts retransferred from inner reserves, and foreign taxes.
- 6 Losses and provision for losses on loans and provision for market valuation of investments other than securities of Canada and the provinces, less recoveries.

OTTAWA,  
January 7, 1963.

K. W. TAYLOR,  
Deputy Minister of Finance.





APPROXIMATE EARNINGS AND EXPENSES PERCENTAGES  
CHARTERED BANKS AND U.S. INSURED COMMERCIAL BANKSCANADA - FISCAL YEARS 1961 : U.S. - CALENDAR YEAR 1961

	<u>Canada</u> %	<u>United States</u> %
<u>Earnings</u>		
Interest and discount on loans	61.4	60.1
Interest, dividends and trading profits on securities	22.3	25.5
Other operating earnings	<u>16.3</u>	<u>14.4</u>
	<u>100.0</u>	<u>100.0</u>
<u>Expenses</u>		
Interest on deposits	33.0	18.7
Remuneration to employees	27.7	25.3
Depreciation of bank premises	2.2	4.4
Other operating expenses	<u>15.5</u>	<u>16.5</u>
	<u>78.4</u>	<u>64.9</u>
Net operating earnings	<u>21.6</u>	<u>35.1</u>
<u>Distribution of net operating earnings</u>		
Provision for losses and additions to inner reserves, net	-6.4	15.3
Provision for income taxes	53.6	35.0
Dividends to shareholders	30.4	22.3
Additions to shareholders' equity	22.4	27.4
	<u>100.0</u>	<u>100.0</u>

Note 1 Source: Annual report of the Federal Deposit Insurance Corporation. Figures adjusted in some cases to fit Canadian titles.



Table 5

## CLASSIFICATION OF LOANS IN CANADIAN CURRENCY

OF

## THE CHARTERED BANKS OF CANADA

	Sept. 30, 1962		Sept. 30, 1961	
	Number of Accounts	Millions of Dollars	Number of Accounts	Millions of Dollars
1. GOVERNMENT AND OTHER PUBLIC SERVICES				
(1) Provincial governments.....	46	32.2	44	10.7
(2) Municipalities and school corporations.....	4,788	334.6	4,691	260.9
(3) Religious, educational, health and welfare institutions.....	7,172	221.5	6,699	192.0
Total Government and Other Public Services.....	12,006	588.3	11,434	463.6
2. INVESTMENT DEALERS AND BROKERS				
(1) Investment dealers, day-to-day, secured.....	67	163.8	68	187.5
(2) Investment dealers, call and short, secured.....	277	47.1	248	49.6
(3) Stockbrokers, call and short, secured.....	459	64.1	493	59.4
Total Investment Dealers and Brokers.....	803	275.0	809	296.5
3. PERSONAL				
(1) Individuals, for other than business purposes				
(a) On the security of Canada Savings Bonds at the agreed rate for the issue.....	85,719	21.2	82,630	22.9
(b) On the security of market- able stocks and bonds.....	131,002	366.5	122,811	319.0
	216,721	387.7	205,441	341.9
(2) Individuals, for other than business purposes				
(a) For Home Improvement, under the National Housing Act...	63,211	70.5	65,443	64.3
(b) On the security of motor vehicles.....	188,624	234.5	146,979	183.5
(c) On the security of other household property.....	55,195	42.2	43,072	34.8
(d) Repayable by instalments, not elsewhere classified...	499,261	364.2	429,292	280.6
(e) Repayable otherwise, not elsewhere classified.....	413,844	560.2	486,133	494.4
Total Personal.....	1,496,856	1,659.3	1,376,360	1,399.5



	Sept. 30, 1962		Sept. 30, 1961	
	Number of Accounts	Millions of Dollars	Number of Accounts	Millions of Dollars
4. AGRICULTURAL, INDUSTRIAL AND COMMERCIAL				
(1) Agriculture				
(a) Farmers, under Farm Improvement Loans Act.....	151,513	223.1	149,892	199.2
(b) Farmers, not elsewhere classified.....	166,231	331.7	156,032	276.4
	317,744	554.8	305,924	475.6
(2) Industry				
(a) Chemical and rubber products	870	58.8	720	51.5
(b) Electrical apparatus and supplies.....	1,508	99.4	1,541	72.0
(c) Food, beverages and tobacco.	6,534	257.9	6,554	209.0
(d) Forest products.....	7,910	212.5	8,165	180.6
(e) Furniture.....	1,420	34.9	1,407	28.2
(f) Iron and steel products.....	3,143	256.1	3,170	194.4
(g) Mining and mine products....	1,514	136.1	1,472	90.3
(h) Petroleum and products.....	886	108.0	1,041	100.0
(i) Textiles, leather and clothing.....	4,293	243.0	4,367	199.0
(j) Transportation equipment....	2,589	95.7	3,684	92.5
(k) Other products.....	4,482	126.6	4,191	108.4
	35,149	1,629.0	36,312	1,325.9
(3) Public utilities, transportation and communication companies				
(a) Guaranteed by a province....	183	27.6	211#	6.4#
(b) Other.....	8,084	207.6	8,526#	158.3#
	8,267	235.2	8,737	164.7
(4) Construction contractors.....	24,837	388.4	25,769	345.8
(5) Grain dealers and exporters.....	732	372.9	843	377.1
(6) Instalment and other finance companies.....	1,033	268.0	1,097	248.0
(7) Merchandisers.....	86,745	1,095.5	89,676	897.2
(8) Other business.....	90,302	981.3	90,918	781.7
Total Agricultural, Industrial and Commercial.....	564,809	5,525.1	559,276	4,616.0
TOTAL LOANS IN CANADIAN CURRENCY (Other than mortgages and hypothecs insured under the National Housing Act, 1954).....	2,074,474	8,047.7	1,947,879	6,775.6

# Revised

## SUPPLEMENTARY INFORMATION

5. Par value of Government of Canada securities held as security for loans in classification 3(1).....	-	129.5	-	123.3
6. Loans to finance companies controlled by industrial corporations included in classification 4(6).....	92	40.6	123	40.8
7. Loans under the Small Businesses Loans Act, gross.....	4,833	39.0	2,234	17.3





Table 6

**STATEMENT OF THE ASSETS AND LIABILITIES  
OF THE QUEBEC SAVINGS BANKS**

as at November 30, 1962

COMPILED FROM RETURNS MADE PURSUANT TO SECTION 83 OF THE QUEBEC SAVINGS BANKS ACT

	The Montreal City and District Savings Bank	La Banque d'Economie de Québec, The Quebec Savings Bank	Total
	\$	\$	\$
<b>ASSETS</b>			
1. Notes of and deposits with Bank of Canada and deposits with chartered banks in Canadian currency.....	24,448,133	3,144,477	27,592,610
2. Other cash, deposits with and balances due from other banks.....	26,926,500	2,253,132	29,179,632
3. Government of Canada direct and guaranteed securities, not exceeding amortized value.....	30,383,394	1,406,790	31,790,184
4. Canadian provincial government direct and guaranteed securities, not exceeding amortized value.....	67,202,547	15,589,871	82,792,418
5. Canadian municipal and school corporation securities, not exceeding market value.....	26,383,424	13,235,247	39,618,671
6. Other Canadian securities and shares, not exceeding market value.....	18,017,792	7,770,270	25,788,062
7. Securities and shares, other than Canadian, not exceeding market value.....	9,507,176		9,507,176
8. Mortgage and hypothecs insured under the National Housing Act, 1954.....	76,718,460	8,471,319	85,189,779
9. Other mortgages and hypothecs, less provision for estimated loss.....	9,875,005	1,076,722	10,951,727
10. Loans otherwise secured, less provision for estimated loss.....	10,863,123	1,589,065	12,452,188
11. Loans without security, less provision for estimated loss.....	180,000	83,000	263,000
12. Poor Fund or Charity Fund investments.....	7,000,000	1,532,438	8,532,438
13. Bank premises at cost, less amounts written off.....	98,876	37,251	136,127
14. Other assets.....			
<b>Total Assets.....</b>	<b>307,604,430</b>	<b>56,189,582</b>	<b>363,794,012</b>
<b>LIABILITIES</b>			
1. Deposits by Government of Canada.....	20,841,278	1,523,644	22,364,922
2. Deposits by Canadian provincial governments.....		1,902,341	1,902,341
3. Deposit liabilities to the public.....	275,301,852	46,112,010	321,413,862
4. Advances from Bank of Canada, secured.....		2,475,000	2,475,000
5. Advances from chartered banks, secured.....	180,000	83,000	263,000
6. Poor Fund or Charity Fund Trust.....	579,176	280,959	860,135
7. Other liabilities.....	2,000,000	1,000,000	3,000,000
8. Capital paid up.....	8,500,000	2,500,000	11,000,000
9. Retained account.....	202,124	312,628	514,752
10. Undivided profits.....			
<b>Total Liabilities.....</b>	<b>307,604,430</b>	<b>56,189,582</b>	<b>363,794,012</b>

DEPARTMENT OF FINANCE,  
OTTAWA, DECEMBER 13, 1962

K. W. TAYLOR,  
Deputy Minister of Finance.

















